THE JOURNAL OF LIBERTARIAN STUDIES

AN INTERDISCIPLINARY QUARTERLY REVIEW

SYMPOSIUM: CHICAGO VERSUS THE FREE MARKET

Walter Block
Henry Simons is Not a Supporter of Free Enterprise

Murray N. Rothbard
Milton Friedman Unraveled

Thomas J. DiLorenzo
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SYMPOSIUM INTRODUCTION

Mention the term "free-market economics" and many people's thoughts immediately turn to the Chicago School, the academic home of nine Nobel prize winners in economics, more than any other program in the world: Milton Freidman (1976), Theodore Schultz (1979), George Stigler (1982), Merton Miller (1990), Ronald Coase (1991), Gary Becker (1992), Robert Fogel (1993), Robert Lucas (1995), and James Heckman (2000). Other Nobel winners who may be considered fellow travelers to the Chicago School include James Buchanan (1986) and Douglass North (1993).

Yet, how sound are their free-market credentials? If put to the test, do such luminaries really come off as true market advocates, or are they merely watered-down versions of such other Nobel-winning economists as Paul Samuelson (1970), Joseph Stiglitz (2001), and George Ackerlof (2001), interventionists all.

This issue of *The Journal of Libertarian Studies* takes a closer look at six famous economists, all leaders or fellow travelers of the Chicago School past or present: Henry Simons (who passed away before the Economics Nobel existed), Friedman, Stigler, Coase, Becker, and North. We look at their views on theory, history, and policy, and find them, well, wanting.

The Journal of Libertarian Studies presents this symposium to help readers understand that the term "free-market economist" does not always carry the obvious meaning, and that not everyone called a free-market economist—regardless of their possession of a Nobel prize—really is devoted to the free market. On this subject, as on so many others, *caveat emptor.*

— Hans-Hermann Hoppe

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HENRY SIMONS IS NOT A SUPPORTER OF FREE ENTERPRISE

Walter Block*

The Chicago School of Economics is seen far and wide as a free-enterprise stronghold. The research programs of many of its members are extolled as supportive of capitalism, even by otherwise knowledgeable commentators.[1] This article will show that such an evaluation cannot be supported, at least in the case of Henry Simons,[2] one of the most eminent practitioners of economics to be associated with the economics department of the University of Chicago.

Perhaps the most disquieting aspect of Simons's treatment of political economy is his insistence on labeling his views "libertarian." It is bad enough that he promotes government intervention into the economy for a host of reasons, such as "coercive association," health, "equality," planning, and education. Such arguments are bad enough in

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[1]See, e.g., John L. Kelly, *Bringing the Market Back In: The Political Revitalization of Market Liberalism* (New York: New York University Press, 1997); and Henri Lepage, *Tomorrow, Capitalism* (La Salle, Ill.: Open Court, 1982).

[2]See Henry Simons, *Economic Policy for a Free Society* (Chicago: University of Chicago Press, 1948). For a defense of this book on supposedly libertarian grounds, see F.A. Hayek, *The Intellectuals and Socialism* (Fairfax, Va.: Institute for Humane Studies, 1990), p. 22, n. 4. Hayek characterizes Simons's book as "one of the most important contributions made in recent times to our problem and . . . just the kind of work which is required to get discussion started on the fundamental issues. Even those who violently disagree with some of its suggestions should welcome it as a contribution which clearly and courageously raises the central problems of our time." For a critique of Hayek's own libertarian credentials, see Walter Block, "Hayek's Road to Serfdom," *Journal of Libertarian Studies* 12, no. 2 (Fall 1996), pp. 327–50.

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that the world is filled with arguments for socialism, interventionism, and government regulation of the economy. Simons's claims are worse in that he does so while calling himself and his ideas "libertarian."[3]

To his credit, Simons is intent upon promoting "free discussion. The virtues of freedom in the pursuit of scientific truth are obvious and undisputed."[4] But what good is free discussion if it is marred to the core by fraudulent mislabeling, characterizing as pro-freedom what is essentially a program, with some notable exceptions to be discussed below, of government intervention into the economy?

LIBERTARIANISM

There are two groups of scholars with a valid claim to the title of libertarian. First, there are the anarcho-capitalists, who maintain that it is only proper, and practical as well, that there be no government at all, since this institution necessarily violates the libertarian axiom of non-aggression against non-aggressors. All supposed state functions would be carried out, in this political economic philosophy, by private-profit making firms or by voluntary charitable organizations.[5]

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[3]Simons, *Economic Policy for a Free Society*, reiterates his claim of being a libertarian, for example, on pp. 1, 4, 6, 7, and 8, sometimes several times on a page. When he is not characterizing his views as libertarian, he more reasonably uses "liberal" as in "classical liberal" as a synonym. His promotion of government intervention on various grounds is found all through his work, e.g., on pp. 2–6. Problematically, throughout the article, he announces himself as a proponent of economic "liberty." He entitles one of his chapters "A Positive Program for Laissez Faire," an instance of fraud and false advertising.

[4]Simons, *Economic Policy for a Free Society*, p. 7. Simons may be forgiven for this sentiment since he wrote long before the advent of political correctness and laws condemning "hate" speech.

[5]For a sampling of this tradition, see Randy E. Barnett, *The Structure of Liberty: Justice and the Rule of Law* (Oxford: Clarendon Press, 1998); Bruce L. Benson, "Enforcement of Private Property Rights in Primitive Societies: Law Without Government," *Journal of Libertarian Studies* 9, no. 1 (Winter 1989), pp. 1–26; Alfred G. Cuzán, "Do We Ever Really Get Out of Anarchy?" *Journal of Libertarian Studies* 3, no. 2 (Summer, 1979); Anthony de Jasay, *Against Politics: On Government, Anarchy, and Order* (London: Routledge, 1997); Hans-Hermann Hoppe, *The Economics and Ethics of Private Property: Studies in Political Economy and Philosophy* (Boston: Kluwer, 1993); Andrew P. Morriss, "Miners, Vigilantes and Cattlemen: Overcoming Free Rider Problems in the Private Provision of Law," *Land and Water Law Review* 33, no. 2 (1998), pp. 581–696; Larry J. Sechrest, "Rand, Anarchy, and Taxes," *The*

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Second, there are the limited-government libertarians, or minarchists, who take the position that a proper government exists only to protect peoples' rights to personal safety and to the security of their legitimately held possessions. To this end, the sole legitimate functions of the state are to provide armies to enable us to resist aggression from abroad, police to quell domestic disturbances, and courts to determine guilt or innocence. Anything more, according to this tradition, constitutes a rights violation.[6]

In what is to follow, I will compare and contrast the viewpoints of Simons with real libertarians. As a benchmark, I choose the minarchists rather than the anarcho-capitalists in that the latter would be an almost impossible benchmark for a Chicago-oriented economist to attain.[7] In this way, Simons has at least a sporting chance of attaining the honorific "libertarian." We start out with a discussion of those policies on the basis of which Simons can take his proper place amongst his fellow members of this philosophy, followed by an examination of the areas in which the views of Simons are greatly at odds with those of limited-government libertarians.

ISSUES ON WHICH SIMONS IS COMPATIBLE WITH LIBERTARIANISM

Fractional-Reserve Banking

Surprisingly, Simons advocates the "abolition of private deposit banking on the basis of fractional reserves."[8] This was so unexpected

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Journal of Ayn Rand Studies 1, no. 1 (Fall 1999), pp. 87–105; and Murray N. Rothbard, "Society Without a State," in *Anarchism: Nomos XIX*, ed. J.R. Pennock and J.W. Chapman (New York: New York University Press, 1978), pp. 191–207.

[6]A few examples of this position include Richard A. Epstein, *Simple Rules for a Complex World* (Cambridge, Mass.: Harvard University Press, 1995); David Boaz, *Libertarianism: A Primer* (New York: Free Press, 1997); Tibor Machan, ed., *The Libertarian Reader* (Totowa, N.J.: Rowman and Littlefield, 1982); Charles Murray, *What It Means to be a Libertarian* (New York: Broadway Books, 1997); Robert Nozick, *Anarchy, State, and Utopia* (New York: Basic Books, 1974); and Leonard E. Read, *Anything That's Peaceful* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1964).

[7]David Friedman is the only Chicago-oriented anarcho-capitalist of whom I am aware. See his *The Machinery of Freedom: Guide to a Radical Capitalism*, 2nd ed. (La Salle, Ill.: Open Court, 1989).

[8]Simons, *Economic Policy for a Free Society*, p. 57.

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that I looked for Simons to contradict himself on this policy, or at least to severely limit its application. He does neither. Instead, he reiterates this policy by advocating:

> Annulment of all existing bank charters . . . and enactment of new federal legislation providing for complete separation . . . of the deposit and lending functions of exiting deposit banks. . . . Legislation requiring that all institutions which maintain deposit liabilities and /or provide checking facilities . . . shall maintain reserves of 100 per cent in cash and deposits with the Federal Reserve Banks.[9]

He reiterated this position two pages later:

> The proposals with reference to banking contemplate displacement of existing deposit banks by at least two distinct types of institutions. First, there would be deposit banks which, maintaining 100 per cent reserves, simply could not fail, so far as depositors were concerned, and could not create or destroy effective money. These institutions would accept deposits just as warehouses accept goods.[10]

And yet again:

> We must abandon and avoid a financial system under which funds actually invested in production and trade are, at the same time, legally available to creditors on demand.[11]

While Simons does allow for the continuation of the Federal Reserve System, instead of its elimination, as would be required by the libertarian philosophy, his clear position on the abolition of fractional-reserve banking is very idiosyncratic for a Chicago School economist.[12]

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[9]Simons, *Economic Policy for a Free Society*, p. 62.

[10]Simons, *Economic Policy for a Free Society*, p. 64.

[11]Simons, *Economic Policy for a Free Society*, p. 80.

[12]Virtually the only economists who argue for the abolition of fractional-reserve banks are from the Austrian School. See, e.g., Walter Block, "Fractional Reserve Banking: An Interdisciplinary Perspective," in *Man, Economy, and Liberty*, ed. Walter Block and Llewellyn H. Rockwell, Jr. (Auburn, Ala.: Ludwig von Mises Institute, 1988), pp. 24–31; John P. Cochran and Steven T. Call, "The Role of Fractional-Reserve Banking and Financial Intermediation in the Money Supply Process: Keynes and the Austrians," *Quarterly Journal of Austrian Economics* 1, no. 3 (Fall 1998), pp. 29–40; Jesús Huerta de Soto, "A Critical Analysis of Central Banks and Fractional-Reserve Free Banking from the Austrian Perspective," *Review of Austrian Economics* 8, no. 2 (1995),

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Price Controls

There is no doubt that Simons is a steadfast and eloquent opponent of price controls. His continual warning against the interference with freely-arrived-at relative prices gives ample testimony to this perspective.

> Political determination of relative prices, of relative returns from investment in different industries, and of relative wages in different occupations implies settlement by peaceful negotiation of conflicts too bitter and too irreconcilable for deliberate adjudication and compromise.[13]

Chicagoans, whatever their other deviations from economic freedom, can traditionally be counted upon to oppose rent control, minimum wages, usury laws, profit limitations, and all other such attempts on the part of government to rig markets, and Simons is no exception to this general rule. For this, libertarians are no doubt in their debt.

Unfortunately, the same cannot be said with regard to regulatory bureaus. Here is what our "laissez faire" advocate Simons had to say about one of the most egregious of these: "We have developed in the Interstate Commerce Commission an unusually competent and scrupulous public body."[14]

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pp. 25–38; Hans-Hermann Hoppe, with Jörg Guido Hülsmann and Walter Block, "Against Fiduciary Media," *Quarterly Journal of Austrian Economics* 1, no. 1 (1998), pp. 19–50; Ludwig von Mises, *The Theory of Money and Credit*, trans. H.E. Baston (Indianapolis, Ind.: LibertyPress / LibertyClassics, 1983), pp. 29–37, 97–154, 399–406; Murray N. Rothbard, *What Has Government Done to Our Money?* (Auburn, Ala.: Ludwig von Mises Institute, 1990); and Mark Skousen, *The 100 Percent Gold Standard: Economics of a Pure Money Commodity* (Lanham, Md.: University Press of America, 1977).

There are, however, numerous otherwise-in-good-standing Austrian economists who have yet to see their way clear to the pellucid understanding of property rights which underlies this position. For example, see Kevin Dowd, *Laissez-Faire Banking* (New York: Routledge, 1996); Roger W. Garrison, *Time and Money* (New York: Routledge, 2000); Steven G. Horwitz, "The Political Economy of Inflation: Public and Private Choices," *Durell Journal of Money and Banking* 3, no. 4 (November 1991), pp. 26–37; and George Selgin and Lawrence H. White, "In Defense of Fiduciary Media," *Review of Austrian Economics* 9, no. 2 (1996), pp. 83–108.

[13]Simons, *Economic Policy for a Free Society*, p. 44.

[14]Simons, *Economic Policy for a Free Society*, p. 50. For more on this, see the discussion below in the section "Redefinition of Laissez Faire."

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The Hoover New Deal

Simons is also to be credited with realizing that Hoover's policies were the logical antecedent to FDR's New Deal. Most commentators fall into the trap of thinking that the New Deal began with Roosevelt; yet, virtually all of FDR's policies were begun by Hoover (although Roosevelt pursued them with greater alacrity and ferocity). Further, Simons condemns the anti-market tendencies of both presidents, making him something of a rarity. He writes:

> One cannot criticize the policies of the present administration without seeming to approve those of its predecessors. In fact, one must condemn the Democrats mainly for their wholesale extension of the worst policies of the past. The N.R.A. is merely Mr. Hoover's trust policy and wage policy writ large. The agricultural measures and many other planning proposals are the logical counterpart and the natural extensions of Republican protectionism.[15]

ISSUES ON WHICH SIMONS IS INCOMPATIBLE WITH LIBERTARIANISM

Although there are several points upon which Simons and libertarians are congruent, it is unfortunate that, on most issues, there is a sharp divergence between the two.

Free Trade

Simons is generally, but not entirely, sound on free trade.[16] He vociferously and frequently criticizes tariffs, quotas, and other such

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[15]Simons, *Economic Policy for a Free Society*, p. 75. For an elaboration of these themes, see Murray N. Rothbard, *America's Great Depression* (Kansas City: Sheed and Ward, 1975); and Murray N. Rothbard, "Herbert Hoover and the Myth of Laissez Faire," in *A New History of Leviathan*, ed. Ronald Radosh and Murray N. Rothbard (New York: E.P. Dutton, 1972), pp. 111–45.

[16]His treatment is marred somewhat by his claim that "[t]he norm in all voluntary economic association is commutative justice. Such justice connotes exchange of equal values, as measured objectively by organized markets." See Simons, *Economic Policy for a Free Society*, p. 4. But this is more than passing curious. It is an insight of the Austrian School that trade connotes exchange of *unequal* values. For example, if I buy your shirt for $10, I must value it at a *higher* rate than that amount at least *ex ante*, or I would lack all motive to purchase it. Alternatively, you must rank the money you receive more favorably that the merchandise you give up, otherwise why would you sell it?

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interferences with international trade. For example, he writes that "Liberalism is also notorious for its uncompromising opposition to governmental restraint or manipulation of foreign trade," and characterizes this as liberalism's—and, by extension, his—"categorical free-trade prescription."[17]

One wonders whether he would have favored a NAFTA, GATT or WTO-type semi-demi free trade (e.g., customs union), or the far more radical libertarian unilateral declaration of immediate free trade with all nations. There is but a hint in his writings that he would not have been this radical:

> Free trade is an essential feature of stable federation. Real international organization, removing sovereign national prerogatives of trade manipulation, must come slowly out of discussion, experiment, and compromise. . . . International organization must be pursued opportunistically on every front.[18]

But this emphasis on supranational institutions and denigration of national sovereignty is logically incompatible with his adherence to subsidiarity and local control.[19]

Notwithstanding this failure to articulate a truly radical libertarian perspective on free trade, there is no doubt that, at least, he is an ardent advocate of economic freedom in this arena. He writes:

> With the disappearance of the vestiges of free trade among nations will come intensification of imperialism and increasingly bitter and irreconcilable conflicts of interest internationally. With the disappearance of free trade within national areas will come endless, destructive conflict among organized economic groups—which should suffice, without assistance from international wars, for the destruction of Western civilization and its institutional heritage.[20]

He also maintains that "opposition to tariffs is, of course, a cardinal element in the liberal creed."[21] But then he fails to carry through on his insight, which is why I list this topic as a negative one for him

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[17]Simons, *Economic Policy for a Free Society*, p. 24.

[18]Simons, *Economic Policy for a Free Society*, p. 26.

[19]See Simons, *Economic Policy for a Free Society*, pp. 11–14; see also the discussion of "Federalism," below.

[20]Simons, *Economic Policy for a Free Society*, p. 45.

[21]Simons, *Economic Policy for a Free Society*, p. 69.

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as far as earning his free enterprise credentials is concerned. He mars his seemingly staunch opposition to interferences with international trade with the following concession:

> The way to reduce the tariff is simply to reduce it. There is, to be sure, a decisive case in favor of gradualness. One must recognize legitimate vested interests in even the most objectionable subsidies. An ideal program would call for a continued scaling-down of duties, with the announced objective of getting rid of them all, over, say, a ten-year period.[22]

This is hard to square with the philosophy of free enterprise. From that perspective, "legitimate vested interests" would be no less a contradiction in terms than "justified theft," or "proper murder." It cannot be denied that if someone were to purchase a position in a subsidized industry at a price that capitalizes the continuation of this program, and the program is suddenly ended, that he would suffer a financial loss. But *caveat emptor* must be served. The buyer of such a firm is speculating that the subsidy will be long continued, and he will suffer no unexpected losses if it does. But this is a far cry from thinking, as Simons evidently does, that these vested interests therefore have a *right* that the program not be pulled out from under them too quickly.

To paraphrase Republican presidential candidate Barry Goldwater, "gradualism in the elimination of evil tariffs is no virtue; immediate eradication is no vice." A person who has the power to rescind an abominable policy at time t_0, and waits to do so until time t_1, might almost be considered guilty of the continuation of this program for the intervening time period. Although Simons talks loudly against tariffs, he refuses precipitous action in ending them, thus blunting his opposition to them.

The Chicago School economist's insistence on gradually rather than immediately eliminating what even he sees as an unconscionable program stands in stark contrast to the views of limited-government libertarians who are a bit more consistent in their adherence to these principles. For example, Leonard Read writes "[i]f there were a button on this rostrum, the pressing of which would release all wage-and-price controls instantaneously, I would put my finger on it and push!"[23]

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[22]Simons, *Economic Policy for a Free Society*, p. 70.

[23]Leonard E. Read, *I'd Push the Button* (New York: Joseph D. McGuire, 1946), p. 3, cited in Murray N. Rothbard, *The Ethics of Liberty* (New York: New York University Press, 1998), p. 259; I owe this cite to Stephan Kinsella.

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And, according to anti-slavery abolitionist William Lloyd Garrison, "gradualism in theory is perpetuity in practice."[24]

Yes, Simons advocates free trade, on a theoretical plane, but what good is this to the free movement of goods and capital across international boundaries if its own self-styled advocate refuses to implement the program when he has the chance to do so? In practice, under a Simons administration, tariffs would live on, his protestations to the contrary notwithstanding.

Freedom of Association

According to Simons:

> A free society must be organized *largely* through voluntary associations. Freedom to associate or dissociate, to belong or not to belong, especially in economic activities, is an essential liberty.[25]

This statement alone takes Simons a long way toward true libertarianism. Were this all there were to the matter, I would be including this topic under the heading of those issues upon which Simons and libertarians are in accord, instead of categorizing it as one in which Simons's views are incompatible with libertarianism.

Unfortunately, the word "largely" is a loophole big enough to drive an eighteen-wheeler through. It is impossible to reconcile freedom of association with any number of other perspectives that earmark the Simons worldview. For example, it is difficult to see how one can square freedom of association with anti-trust; the former stipulates that any person can associate with any other person he wants to, the latter that business firms cannot do so with each other. Similarly for coerced socialism, which mandates that people join forces with one another, economically speaking, when what they may wish most is to live in splendid isolation from one another.[26]

Monopoly and Competition

Simons writes:

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[24]William H. Pease and Jane Pease, eds., *The Antislavery Argument* (Indianapolis, Ind.: Bobbs-Merrill, 1965), p. xxxv; cited in Rothbard, *Ethics of Liberty*, p. 260; I owe this cite to Stephan Kinsella and Karen DeCoster.

[25]Simons, *Economic Policy for a Free Society*, p. 3, emphasis added.

[26]See below for a discussion of each of these topics.

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> Economics properly stresses competition among organizations as a means to proper resource allocation and combination and to commutative justice. But effective competition is . . . requisite to real freedom of association—and to real power dispersion. All monopolies, and all very large organizations of sellers (or buyers), are impairment of that freedom and . . . must tend to be governmentalized, not only because they involve exploitation . . . and diseconomies, but also because adequately strong government cannot tolerate usurpation of its coercive powers.[27]

There is so much wrong here it is hard to know where to begin. First, there is the confusion between size, or numbers of competitors, and actual competition. There is no competition permitted between the taxi-cab drivers of New York City, even though there are tens of thousands of them, while there are only two people competing with one another in the boxing ring, and yet their competition can become pretty intense. Mere nose counting is no guarantee of rivalrousness in competition. Were Simons to consistently follow through on his viewpoint, moreover, he would have to characterize monogamous marriage as bi-lateral monopoly, and then ban it by law. For in this case, each of the two parties "forswears" all others; no one else is allowed to compete for the sexual and emotional "services" of either of the spouses, nor are either of them enabled to involve themselves in any such activity with outside "competing" parties.[28]

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[27]Simons, *Economic Policy for a Free Society*, p. 4.

[28]Nor can it be argued in Simons's defense that his economic insight applies only to commercial activities, not personal ones. If there is anything to which the career of Gary Becker (a fellow Chicago School economist) is devoted, it is to the notion that economics applies, holus bolus, to *all* realms of human endeavor, particularly including sex. See Gary S. Becker, *Altruism in the Family and Selfishness in the Market* (Chicago: Center for the Study of the Economy and the State, 1982); Gary S. Becker, *Accounting for Tastes* (Cambridge, Mass.: Harvard University Press, 1998); Gary S. Becker, *A Treatise on the Family* (Cambridge, Mass.: Harvard University Press, 1991); and Gary S. Becker, *A Theory of Marriage* (Chicago: Center for the Study of the Economy and the State, 1975), where he applies economics to issues of family, sex, etc. Richard Posner is another Chicago School economist who adopts similar subject matter for his analysis. See Richard A. Posner, *Sex and Reason* (Cambridge, Mass.: Harvard University Press, 1992). On these grounds, Becker and Posner join with the Austrians, who maintain that all "human actions" are the proper province of the dismal science. See Ludwig von Mises, *Human Action*, scholar's ed. (Auburn, Ala.: Ludwig von Mises Institute, 1998).

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Second, economics has nothing whatsoever to say about "commutative justice" or any other kind of justice. This claim bespeaks a conflation between the normative and the positive elements of economics.[29]

Third, there is a mix-up between coercive power and large size. Here is yet another indication that Simons's concept of coercion is not that of the libertarian. He states that "[a] moral order imposed by force or fraud, by authorities, or by threats of punishment in this world or the next is a contradiction in terms."[30] On the contrary, it all depends upon what the moral order is. If it consists of proscriptions against murder, rape, and theft, then it is entirely justified that this be imposed by violent means. Even if the moral order comprises no more than you should do (legal) things my way, it is licit to impose this, too, if the threat of punishment is that I, as your employer, fire you. Further, banning threats about the next world seems to indicate forced atheism. Have not religious people the right to propound their views? Likewise, an organization with many members is not necessarily a coercive one, nor does it take many people to act in an intimidating manner; a small gang will do quite nicely in this regard, as will even a single hold-up man.

Then there is the issue of what happened to the "freedom of association" that is much-vaunted in Simons's lexicon? As we have seen above, our author is on record as supporting this freedom. But a cartel, or a conglomerate, or a vertically or even horizontally integrated industry is merely a voluntary association all of whose members have freely joined. How Simons can be in favor of freedom of association, but opposed to, and willing to use the forces of law against, a cartel, can perhaps only be understood in Chicago, where the laws of logic apparently operate in a different manner than they do everywhere else.

Can it be argued that I am being too harsh on Simons, in that he sees anti-trust legislation only as a transitory measure? After all, he writes:

> Public regulation of private monopoly would seem to be, at best, an anomalous arrangement, tolerable only as a temporary expedient. Halfhearted, sporadic, principle-less

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[29]Leland B. Yeager, *Ethics as Social Science: The Moral Philosophy of Social Cooperation* (Cheltenham, U.K.: Edward Elgar, 2001), correctly argues that economics sets the limits for moral reasoning in that, for something to be moral, it must at least be possible, and economic reasoning can often show that the typical socialist nostrum is infeasible.

[30]Simons, *Economic Policy for a Free Society*, pp. 7–8.

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> regulation is a misfortune for all concerned; and systematic regulation, on the basis of any definite and adequate principle, would leave private ownership almost without a significant function or responsibility to discharge. . . . We may endure regulation for a time, on the dubious assumption that governments are more nearly competent to regulate than to operate.[31]

But no. For what he means to follow this "temporary expedient" is not a return to the laissez-faire policy of no anti-trust regulation at all; rather, he is calling for a general public takeover of industry!

> In general, however, the state should face the necessity of actually taking over, owning, and managing directly, both the railroads and the utilities, and all other industries in which it is impossible to maintain effectively competitive conditions.[32]

For Simons, any industry in which the concentration ratio is higher than he thinks it should be is one which does not maintain "effectively competitive conditions." However, concentration ratios are wildly subjective matters, depending upon, among other things, how widely or narrowly an industry is defined. Thus, in principle Simons's principles offer virtually no limit to the percentage of the economy that can be nationalized.

With regard to railroads, Simons seems particularly unhappy about the "preposterous system of relative charges (freight classification), and the disastrous rigidity of freight rates."[33] Yet, these stem not from anything intrinsic to this or any other industry, but from the legal limitations imposed upon all potential railroads to set up as competitors.

Taxation

What would taxes be like in the relatively free society of the minarchists? For some, there would be no taxes at all, and government services would be financed through voluntary contributions.[34] For others, tax levels would be minimal, yielding at most 10% of GDP, similar to the amount of the tithe which was sometimes imposed, and

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[31]Simons, *Economic Policy for a Free Society*, p. 51.

[32]Simons, *Economic Policy for a Free Society*, p. 51.

[33]Simons, *Economic Policy for a Free Society*, p. 50.

[34]See, e.g., Ayn Rand, *The Virtue of Selfishness* (New York: New American Library, 1962).

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sometimes requested, by the church of its members.[35] As to the level of taxation, Simons would appear to pass the minarchist test at least adequately, when he calls for "arrangements whereby something like 10 per cent of the whole national income would pass, via personal income taxation, into the hands of government." But this moderation is more apparent than real, in that in addition to taxing income at this relatively low rate Simons would also maintain other excises:

> Levies like the gasoline taxes might well be retained indefinitely. . . . Taxes upon real property also might properly be retained without diminution of long-established rates.[36]

His justification for these confiscations is also problematic:

> Such property has long been bought and sold subject to the prospect of continued taxation; to reduce the levies would involve a large gift by the community (through increase in capital value) to persons who happened to be in possession at the time.[37]

But this is no less than appalling. If we follow Simons's "logic" in other areas, the police should not try to reduce crime either, for homes will have been purchased assuming such continued depredations, and if they are reduced, property values will undoubtedly tend to rise, *ceteris paribus*, and this would constitute an unwarranted "gift" from society as a whole to those people fortunate enough to own land in the previously dangerous neighborhoods.

What forms of taxes are compatible with minarchism, the philosophy we are using as a benchmark to analyze the views of Simons? There are four main possibilities: progressive, proportional, regressive, or equal (such as a poll or head tax, where each citizen pays the same absolute amount of money to the government). My claim is that they are compatible with free enterprise in reverse order to that specified above: a head tax is the most compatible with libertarianism, next comes the regressive, after that the proportional, and the least consistent with the free society is the progressive tax.[38] Why is this?

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[35]Most of the limited-government advocates listed in ft. 6 *supra* would favor limited taxes of this sort.

[36]Simons, *Economic Policy for a Free Society*, p. 68.

[37]Simons, *Economic Policy for a Free Society*, p. 68.

[38]See on this Murray N. Rothbard, *Power and Market: Government and the Economy* (Menlo Park, Calif.: Institute for Humane Studies, 1970).

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It is because the emblem of the market place is the price system. A wealthy man, such as Microsoft's Bill Gates, pays *exactly the same price* for a loaf of bread as I do. Therefore, if we are to model taxes on the basis of prices, and there is no other alternative that is even remotely a reasonable candidate to emulate for this purpose, then this computer whiz must pay exactly what I do in the form of taxes. This implies a poll tax, where all citizens pay identical amounts to the revenue agents. Next best, from this perspective, would be any regressive tax where the rich paid more than the poor in absolute dollars, although less in percentage terms, because this most closely replicates the equal tax. Third best would be a proportional tax, and last, the progressive, because these resemble, less and less, the price system.

It will come as no surprise to the reader to learn that Simons favors the progressive tax. He writes:

> Our proposal with reference to taxation is based on the view (1) that reduction of inequality is per se immensely important; (2) that progressive taxation is both an effective means and, . . . the only effective means to that end.[39]

This element is so important that even if it were Simons's only deviation, it would extinguish his claim to be a free-enterprise advocate.

Under his tax proposals, Simons gives a prominent place to attacking inheritances, going so far as to advocate the inclusion of gifts in this regard.[40] What he has in mind is monetary assistance or large consumer durables (e.g., houses, cars) that parents give to children. But why single out these instances to the exclusion of other sorts of aid? Surely, if we adopt the Simons philosophy on this matter, we should also include penalties for love and affection, for reading stories to children at bedtime, for having books and music in the house, for scintillating dinner time conversation, etc. For these things also, and maybe even more effectively, contribute to the well being of the next generation. And this must perforce be "unfair," as the rich tend to give more of these to their children than do the poor.

Money

It is Simons's considered opinion that:

> [t]olerable functioning of a free enterprise system presupposes effective performance of a fundamental function of

[39]Simons, *Economic Policy for a Free Society*, p. 65.
[40]Simons, *Economic Policy for a Free Society*, p. 67.

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> government, namely, regulation of the circulating medium (money).

But this is not easy to understand, given his highly critical account of the way the U.S. government has actually acquitted this task.

> We should characterize as insane a governmental policy of alternately expanding rapidly and contracting precipitously the quantity of paper currency in circulation—as a malevolent dictator easily could do, first issuing currency to cover fiscal deficits, and then retiring currency from surplus revenues. Yet that is essentially the kind of monetary policy which actually obtains.[41]

Simons's implication is that if the government were a stabilizing instead of a destabilizing force in monetary matters, then all would be well. But this would not be good enough for the libertarian, who would still insist upon free-enterprise money. Since gold was always chosen whenever people were free to determine the monetary commodity for themselves, it is hard for the libertarian to resist the call for a return to this standard.[42] Even if government could be trusted with so delicate and important an institution as money, which it cannot be, it would still be a rights violation for the one group in society with a legal monopoly of violence to exceed its proper role, which is limited to safeguarding our persons and property.

Compulsory Egalitarianism

Simons refers to "the real problem of inequality," and maintains that "we may and properly do sharply modify the distributional results of free exchange." His opinion is that "the best mitigation of inequality

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[41]Simons, *Economic Policy for a Free Society*, p. 54.

[42]For the Austrian case in favor of market money, such as the gold standard, see, e.g., Richard M. Ebeling, "The Gold Standard: Ludwig von Mises and the Austrians," in *The Gold Standard: An Austrian Perspective*, ed. Llewellyn H. Rockwell, Jr. (Lexington, Mass.: Lexington Books, 1985); John B. Egger, "Arthur Marget in the Austrian Tradition of the Theory of Money," *Review of Austrian Economics* 8, no. 2 (1995) pp. 3–23; Ron Paul and Lewis E. Lehrman, *The Case for Gold* (Washington, D.C.: Cato Institute, 1982); George Reisman, *Capitalism: A Treatise on Economics* (Ottawa, Ill.: Jameson Books, 1996), pp. 503–41, 895–966; Murray N. Rothbard, *The Mystery of Banking* (New York: Richardson and Snyder, 1983); and Joseph T. Salerno, "Ludwig von Mises on Inflation and Expectations," in *Advances in Austrian Economics*, vol. 2, ed. Peter Boettke and Mario J. Rizzo (Greenwich, Conn.: JAI Press, 1995), pp. 297–326.

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will involve progressive equalization of personal or family contributions to the social income," e.g., a progressive income tax. Moreover, this author posits that "Freedom and equality convey, among libertarians, similar and complementary meanings."[43]

Left unexplained, however, is why any advocate of free enterprise should have such a fetish for income or wealth equality that he is willing to invoke the power of the state to this end. It is one thing to have this taste as a matter of personal preference, completely divorced from political economy. This is certainly compatible with laissez-faire capitalism, as long as the means toward this end were all voluntary; Simons would not lose any market credentials if he advocated egalitarianism through private charity, but this is not at all his view. Instead, he elevates this into one of his bedrock principles, something no legitimate free-enterprise advocate could possibly do.

Why not egalitarianism for non-monetary characteristics, such as beauty, intelligence, sense of humor, musical ability? How many of his own or that of his children's IQ points would Simons be willing to give up to those in more need of them for the cause of social justice?[44] I suspect not a one, which renders his obsession with equality rather hypocritical, as is usually the case in such matters.

Federalism

Simons's adherence to federalism would, for the most part, be applauded by libertarians.[45] After all, long-suffering citizens have more alternatives to a pernicious local municipality than they have to

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[43]Simons, *Economic Policy for a Free Society*, pp. 5, 6, 7.

[44]Kurt Vonnegut's short story "Harrison Bergeron," in *Welcome to the Monkey House* (New York: Dell, 1968), suggests just such a situation. The story's title character is better looking, smarter, stronger, better coordinated, more musically inclined, and so on than are other humans. Thus, he is the nemesis of the "Handicapper General," whose job is to ensure that everyone is "equal." Bergeron is fitted with clunky and asymmetric weights, ill-fitting shoes, eyeglasses with distorting lenses, and other remedial responses, all in the name of "equality."

[45]Simons, *Economic Policy for a Free Society*, pp. 11–14. However, I have argued elsewhere that decentralization is at best a presumption which can be overcome by other libertarian considerations. See Walter Block, "Decentralization, Subsidiarity, Rodney King, and State Deification: A Libertarian Analysis," *European Journal of Law and Economics* 16 (2003); Robert Lawson and Walter Block, "Government Decentralization and Economic Freedom," *Asian Economic Review* 38, no. 2 (December 1996), pp. 421–34.

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a pernicious state. Likewise, if the laws of one state become onerous, citizens can go to another state under our federal system. With a unitary system, citizens have fewer options to avoid government despotism.

This is akin to the Catholic social thought teaching on the importance of subsidiarity, e.g., placing the most reliance on the smallest local elements of government (villages, towns, counties), and the least upon the federal government According to Michael Novak, subsidiarity is based on the idea that "human life proceeds most intelligently and creatively when decisions are made at the level closest to concrete reality, and when next-higher levels of decision-making are invoked only as a last resort."[46]

The only problem with Simons's advocacy of federalism is that he is not really serious about it. For example, he advocates "Transfer, to the federal government of the exclusive power to charter ordinary, private corporations, and subsequent annulment of all charters granted by the states." So that there can be no mistake about this, he also claims that "The right to charter large corporations must be vested exclusively in the federal government."[47] This economist is supposedly an advocate of competition, but, seemingly, this does not apply to that between government entities. If one state acts inappropriately with regard to chartering corporations, there are 49 others at least potentially able to offer other options; if the federal government acts mischievously in this regard, there are no other alternatives, at least domestically.

Coercion

Simons's grasp of the difference between coercion and voluntary cooperation is rather tenuous.[48] He avers that "local [governmental] bodies are themselves largely voluntary associations," and that:

> modern democracy rests upon free, responsible local government . . . . [Such f]ree responsible local bodies correspond,

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[46]Michael Novak, *The Spirit of Democratic Capitalism* (New York: Simon & Schuster, 1978), p. 179.

[47]Simons, *Economic Policy for a Free Society*, pp. 58, 81.

[48]He is joined in this flaw by others who also mistakenly characterize themselves as libertarians. See James M. Buchanan, "An Economic Theory of Clubs," *Economica* 32 (February 1965), pp. 1–14; and Randall G. Holcombe, *The Economic Foundations of Government* (New York: New York University Press, 1994). For a rejoinder, see Walter Block, "National Defense and the Theory of Externalities, Public Goods, and Clubs," in *The Myth of National Defense*, ed. Hans-Hermann Hoppe (Auburn, Ala.: Ludwig von Mises Institute, 2003), pp. 299–332.

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> in the political system, to free responsible individuals or families and voluntary associations.[49]

But anyone who cannot distinguish between a private club, voluntary association, or condominium council on the one hand, and a town or municipal council on the other, is reckoning in the absence of the most important dissimilarity in all of political economy. There are similarities between a swimming pool run by the local Y.M.C.A. and one managed by the village government, but the differences are crucial. In the one case, dues or fees are entirely voluntary; in the other, if you refuse to pay, you go to jail. That such a stark difference can be overlooked by an otherwise astute political commentator must always be a source of amazement.

Simons buys heavily into Lord Acton's refrain to the effect that "Power corrupts, and absolute power corrupts absolutely," but fails to distinguish between aggressive and defensive power. Ideally, the former should be completely obliterated,[50] but the same does not apply to the latter. Libertarians are not pacifists, after all. Simons is mistaken when he writes that a "cardinal tenet of libertarians is that no one may be trusted with *much* power."[51] The point is that no one should have *any* offensive power whatsoever. This is completely apart from whether they should be *trusted* with it. Further, they may have as much *defensive* power as they wish, since this is per se unobjectionable.

Simons's views on the evils of large concentration of business are so deeply embedded in his philosophy that they permeate his views on many other issues as well, particularly including the present one under discussion. To wit, he equates "despotism" and "monopoly."[52] This means that if an industry is highly concentrated, it is to that extent guilty of violating the libertarian non-aggression axiom.

Contrast this with Mises, who wrote with regard to the anti-trusters who accuse large firms of holding back on production, that is, of not producing enough: "If the grumbler knew better, why did he not himself fill the gap and seize the opportunity to earn profits?"[53]

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[49]Simons, *Economic Policy for a Free Society*, pp. 12, 13.

[50]This is the agenda of the anarcho-capitalists, see ft. 5, *supra.*

[51]Simons, *Economic Policy for a Free Society*, p. 23, emphasis added.

[52]Simons, *Economic Policy for a Free Society*, p. 27.

[53]Ludwig von Mises, "Profit and Loss," in *Planning for Freedom*, 2nd ed. (South Holland, Ill.: Libertarian Press, 1962), p. 114. I owe this cite to Joe Salerno and John Bratland.

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Private Property

Simons favors the institution of private property, so there is a case for placing this topic among those upon which his views are compatible with libertarianism.[54] But his advocacy of property rights is so hemmed in and qualified by his support for egalitarianism and opposition to business concentration that this is not possible. Consider the following statement:

> The libertarian good society lies . . . in the maximum dispersion of property compatible with effective production or, as process, in progressive reconciliation of conflicts between equality and efficiency.[55]

In the Simonsian system, in other words, property is not at the bedrock. It will be tolerated, but only to the extent that it does not conflict with, of all things, "equality." To say that this is a stark difference from real libertarianism would be a strong understatement.

Simons continues: "Property in one's own services . . . is a secure, substantial right only where there are many possible buyers."[56] At the time of this writing, I have just come across the invention of a new shirt. According to the announcement of its availability,[57] it never has to be ironed, but comes with a hefty price tag: about $5,000.00. Apart from perhaps a few rock stars and professional athletes, not only will there not be "many possible buyers," it is exceedingly possible that there will be no buyers at all for this product. Simons's statements imply that the owners of this innovative shirt have less than full private property rights in their investment, since there are very few buyers for this product. Such a determination seems difficult to maintain, however. This is surely a confusion between security of property—which we have no reason to question in the case of the shirt—and the numerous potential buyers required by the perfectly competitive model—who are completely lacking.[58] What one thing has to do with the other is

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[54]Simons, *Economic Policy for a Free Society*, pp. 32–33.

[55]Simons, *Economic Policy for a Free Society*, p. 27.

[56]Simons, *Economic Policy for a Free Society*, p. 27.

[57]*http://portal.telegraph.co.uk/news/main.jhtml?xml=/news/2001/07/26/wshirt26.xml*, 7/27/01.

[58]I should say, in "defense" of Simons's views on property, that they are far superior to those of his fellow Chicagoite Ronald Coase. At least for Simons, there is such a thing as private property, no matter how severely truncated. For Coase, this does not at all hold. For a critique of Coase's views on property, see, e.g., Walter Block, "Private Property Rights, Erroneous Interpretations, Morality, and Economics: Reply to Demsetz," *Quarterly Journal of Austrian*

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an insight vouchsafed, it would seem, only to those who occupy postal code 60617.

Socialism

One would think that whatever Simons's deviations from libertarianism, he would at least distinguish his own views from those of socialists.[59] Instead, here is what he had to say on that topic:

> (Socialist) intellectuals have finally begun to face the task of drafting positive proposals and an intelligible platform for action. . . . Socialism has thus almost ceased to be distinctive ideology. . . .
>
> Socialism, of necessity, has been deeply corrupted by liberalism and conversely, for they have been contemporaries in a world of free discussion and have been catalyzed by the same evils and guided by much the same aspirations. Indeed, it is now hard to see how socialists and libertarians can long sustain intellectual differences. . . . Modern socialism is avowedly concerned mainly about inequalities of wealth . . . and about industrial monopoly—both major concerns of libertarians.[60]

The first reaction of the true libertarian must be "Speak for yourself, Simons; don't drag us into the socialist morass." This is not only moral equivalence (the same aspirations indeed!), but it is economic

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Economics 3, no. 1 (Spring 2000), pp. 63–78; Roy Cordato, "Time Passage and the Economics of Coming to the Nuisance: Reassessing the Coasean Perspective," *Campbell Law Review* 20, no. 2 (Spring 1998), pp. 273–92; Elisabeth Krecke, "Law and the Market Order: An Austrian Critique of the Economic Analysis of Law," *Journal des Economistes et des Etudes Humaines* 7, no. 1 (March 1996), pp. 19–37; and Murray N. Rothbard, "Law, Property Rights, and Air Pollution," in *Economics and the Environment: A Reconciliation*, ed. Walter Block (Vancouver, B.C.: Fraser Institute, 1990), pp. 233–79.

[59]We must be ever mindful of the distinction between voluntary and coercive socialism. In the former case, the Marxian notion of "from each according to ability, to each according to need" is entrenched in a voluntary manner, as in the case of the family, the monastery, the nunnery, the kibbutz (counterfactually, I assume that these are not supported through general tax revenues), the cooperative, or the commune. In the latter case, this aphorism is upheld (or, rather, lip service is paid to it) but on a compulsory basis, as is done in the old U.S.S.R., "Red" China (during previous decades), North Korea, Cuba, etc. In the text, it will be the latter sense of socialism that is utilized.

[60]Simons, *Economic Policy for a Free Society*, pp. 29–30.

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equivalence to boot (both are concerned with egalitarianism and opposition to large-scale industry). Let is be said once and for all, loudly and clearly: libertarians are not at all "concerned" with equalization of wealth or income. It is just as much theft when a poor person steals from a rich one, whether on an individual basis or through the intermediation of the state, as when the reverse occurs. The libertarian opposes theft, period. There are no two separate problems of production and distribution. To say that there are is to elevate naked robbery into an arm of political economy. Nor are libertarians "concerned" about industrial concentration. As long as the strong market position of the large firm was earned honestly, by producing a better product at a lower price, his property is as honestly earned as that of anyone else. True, if the dominant size came about through government grants of special privileges, denied to competitors, it is illegitimate. But it is the antecedents of the holdings of the large business concern that is the problem, not the size per se. If these special privileges eventuated in a small firm, they would be equally improper.

Socialism has laid waste to vast numbers of people; it has brought in its train inefficiency, inability to rationally calculate, and countless deaths. To compare it favorably with capitalism is to be guilty of an astoundingly atrocious error.[61]

Labor Unions

Organized labor has one legal power denied to virtually all other institutions in society, bar government: a legal ability to initiate violence

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[61]This is in sharp contrast to the Austrian total and utter dismissal of socialism. See David Gordon, *Resurrecting Marx: The Analytical Marxists on Freedom, Exploitation, and Justice* (New Brunswick, N.J.: Transaction Publishers, 1990); Trygve J.B. Hoff, *Economic Calculation in the Socialist Society* (Indianapolis, Ind.: LibertyPress, 1981); Hans-Hermann Hoppe, *A Theory of Socialism and Capitalism* (Boston, Mass.: Kluwer Academic Publishers, 1989); Yuri N. Malt-sev, *Requiem for Marx* (Auburn, Ala.: Ludwig von Mises Institute, 1993); Peter Murrell, "Did the Theory of Market Socialism Answer the Challenge of Ludwig von Mises? A Reinterpretation of the Socialist Controversy," *History of Political Economy* 15, no. 1 (Spring 1983), pp. 92–105; Murray N. Rothbard, "The End of Socialism and the Calculation Debate Revisited," *Review of Austrian Economics* 5, no. 2 (1991), pp. 51–70; Murray N. Rothbard, "Karl Marx: Communist as Religious Eschatologist," *Review of Austrian Economics* 4 (1990), pp. 123–79; and Karen I. Vaughn, "Economic Calculation Under Socialism: The Austrian Contribution," *Economic Inquiry* 18 (June 1980), pp. 535–54.

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against non-aggressing individuals. The people commonly abused in this way are first denigrated as "scabs,"[62] and then are brutalized[63] when they try to compete for jobs held by union members. Simons favors "competition," but, seemingly not in labor markets. The excuse used by organized labor to beat up scabs in either this blue or white-collar style is that they are trying to steal jobs from the rank and file. But a moment's reflection will reveal the error of looking at the matter in this way. For a job is the embodiment of an agreement between *two* contracting parties, the employer and the employee. It is just as silly to maintain that the worker owns his job as that the firm does.[64]

But Simons does not at all concur in this analysis. Unions are not per se gangster organizations for him. Rather, it is their size alone, not their behavior, which is at issue, "Like corporations and up to about the same size or scale, unions have real social uses."[65] But perhaps I go too quickly. For in another passage, Simons does focus on not their size, but their conduct: "If trade unions could somehow be prevented from indulging in restrictive monopolistic practices, they might become invaluable institutions."[66] However, this will not do. For what

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[62]Where are our "human rights" commissions, charged with stamping out "hate," when we need them? On a more serious note, the libertarian objection is not to name calling ("sticks and stones may break my bones but names can never harm me," goes the childhood nursery rhyme) but to the initiation of violence that often follows in its track.

[63]The brutalization is hidden, not ended, when a veneer of legality is placed over it by labor laws such as the Wagner Act. These require that the employer bargain fairly with the union, e.g., he is prevented from hiring scabs as surely as if physical force were still the main means of precluding the latter from competing for jobs. See Bill Kauffman, "The Child Labor Amendment Debate of the 1920's; or, Catholics and Mugwumps and Farmers," *Journal of Libertarian Studies* 10, no. 2, (Fall 1992), pp. 139–70; Robert W. McGee, "If Dwarf Tossing Is Outlawed, Only Outlaws Will Toss Dwarfs: Is Dwarf Tossing a Victimless Crime?" *American Journal of Jurisprudence* 38 (1993), pp. 335–58; and Morgan O. Reynolds, *Power and Privilege: Labor Unions in America* (New York: Manhattan Institute for Policy Research, 1984).

[64]Pascal Salin, "The Firm in a Free Society: Following Bastiat's Insights," *Journal of Libertarian Studies* 16, no. 3 (Summer 2002), pp. 1–18, substantially elucidates this position.

[65]Simons, *Economic Policy for a Free Society*, p. 35.

[66]Simons, *Economic Policy for a Free Society*, p. 60. To buttress this point, he again likens "trade-union monopoly" to that pertaining to business. Simons, *Economic Policy for a Free Society*, p. 48.

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Simons is now castigating organized labor about is precisely that for which he finds fault in business: deviating from the tenets of perfect competition. In other words, the concept "restrictive monopolistic practices" has two entirely different and incompatible meanings. On the one hand, it can mean having too few buyers or sellers, e.g., being insufficiently perfectly competitive. On the other it can mean using physical force (beating up scabs, compulsory labor legislation).[67] But Simons never even comes remotely close to employing this concept in the second of these two meanings. Rather, for him, the problem with unions is *not* that they violate the libertarian axiom of non-aggression against non-aggressors, but rather that they, along with businesses, do not adhere closely enough to the strictures of perfect competition for his taste. When put in this way, it is difficult to deflect the view that this position, let alone being incompatible with libertarianism, constitutes no less than a moral perversity.

Goals

In Simons's view:

> There is in America no important disagreement as to the proper objectives of economic policy—larger real income, greater regularity of production and employment, reduction of inequality.[68]

This might well be true if we can characterize the opinions of real libertarians as "unimportant." But if not, then there are problems with this statement. We have already discussed the third of these goals, so we now focus on the first two.

Take "larger real income" first. This sounds like a mom-and-apple-pie desire, and to the extent that it is, it has no place in a serious tract on public policy. Who, after all, can be against greater wealth? But even here, there are difficulties, as there are always ascetics who oppose a larger pie for reasons of principle, and the basis upon which we can with impunity ignore their wishes is unclear.[69]

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[67]McDonald's never sends Ronald into Burger King to blow it up, nor does Col. Sanders do anything of the kind to the other fast-food emporia. Unfortunately, the same cannot be said for union treatment of scabs or of employers.

[68]Simons, *Economic Policy for a Free Society*, p. 40.

[69]On the dangers of interpersonal comparisons of utility, and on the importance of subjectivism in all such calculations, see William Barnett II, "Subjective Cost Revisited," *Review of Austrian Economics* 3 (1989), pp. 137–38; James M.

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In any realistic analysis, the only way to attain greater wealth in the future, other things equal, is to sacrifice more in the present. Simons's claim that the economy is not growing as fast as it should be is equivalent to an implicit claim that our social time-preference rate is too high. But he neither puts forth any evidence for this claim nor even realizes that it is incumbent upon him to do so.[70]

A similar problem pertains to Simons's claim that we need "greater regularity of production and employment." Superficially, this sounds reasonable. There are surely very few people who favor the Great Depression, and Simons is objecting to that state of affairs. But the economic debacle of the 1930s was due to malignant governmental interference in the banking system in the first place,[71] so it comes with particular ill grace for an advocate of regulation, such as Simons, to call for an alleviation of this difficulty.

Redefinition of Laissez Faire

If there is one thing clear on the definitional front, it is that "laissez faire" depicts a system of political economy where "that government is best which governs least." Another accurate way to denote what it is that government would do under this policy is the "night watchman state." it would be pretty much limited to the vision of the minarchist view, with which we are contrasting Simons's: armies, courts, and police.

Buchanan, *Cost and Choice: An Inquiry into Economic Theory* (Chicago: Markham, 1969); Mises, *Human Action*; Murray N. Rothbard, "Toward a Reconstruction of Utility and Welfare Economics," in *Method, Money, and the Austrian School*, vol. 1 of *The Logic of Action* (Cheltenham, U.K.: Edward Elgar, 1997).

[70]See on this Roger Garrison, "The Intertemporal Adam Smith," *Quarterly Journal of Austrian Economics* 1, no. 1 (Spring 1998), pp. 51–60.

[71]See, e.g., John P. Cochran and Fred R. Glahe, "The Keynes-Hayek Debate: Lessons for Contemporary Business Cycle Theorists," *History of Political Economy* 26, no. 1 (1994), pp. 69–94; Roger W. Garrison, "The Austrian Theory of the Business Cycle in the Light of Modern Macroeconomics," *Review of Austrian Economics* 3 (1989), pp. 3–30; Rothbard, *America's Great Depression*, pp. 11–38; Gene Smiley, "Can Keynesianism Explain the 1930s?" *Critical Review* 5, no. 1 (1991), pp. 81–114; Richard K. Vedder and Lowell Gallaway, "The Great Depression of 1946," *Review of Austrian Economics* 5, no. 2 (1991), pp. 3–33; and U. Witt, "The Hayekian Puzzle: Spontaneous Order and the Business Cycle," *Scottish Journal of Political Economy* 44, no. 1 (1997), pp. 44–58.

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According to our author, however, this is wildly mistaken.

> The representation of laissez faire as a merely do-nothing policy is unfortunate and misleading. . . . The state is charged, under this "division of labor," with heavy responsibilities and large "control" functions: the maintenance of competitive conditions in industry; the control of the currency (of the quantity and value of the effective money); the definition of the institution of property . . . not to mention the many social welfare activities.[72]

For Simons, the promotion of competition indicates something along the lines of anti-trust law, an issue with which we have already dealt. Similarly, money, mentioned previously, can function quite well in the absence of any government involvement whatsoever.[73] Likewise, "social welfare" is just a polite term for robbery of the rich on behalf of the poor and middle class.

If laissez faire is to connote an activist government a la Simon, then we shall need another word, entirely a different one, to indicate what this phrase formerly depicted, previous to the "contribution" of that author. Very much to the contrary, however, it is Simon who is attempting to hijack laissez faire so as to suit his own interventionistic proclivities. Rather than taking the honest course of admitting that he can in no way, shape, manner, or form be considered an advocate of laissez-faire capitalism, he attempts to capture this word for his own use, after emptying it of virtually all its original content. He cannot be allowed to get away with this trick of verbal legerdemain.

The Corporation

It would appear that there would not be much use for corporations in the version of laissez-faire capitalism that Simons peddles.

> We may recognize, in the almost unlimited grants of powers to corporate bodies, one of the greatest sins of governments against the free enterprise system. There is simply no excuse, except for a narrow and specialized class of enterprises, for allowing corporations to hold stock in other corporations—and no reasonable excuse (the utilities apart) for hundred-million-dollar corporations, no matter what form their property may take. Even if the much-advertised economies of gigantic financial combinations were real,

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[72]Simons, *Economic Policy for a Free Society*, p. 42.

[73]Apart from, for the limited-government statist, protection against fraud (e.g., counterfeiting).

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> sound policy would wisely sacrifice these economies to preservation of more economic freedom and equality.[74]

It is safe to say that Simons would not recognize "economic freedom" if it bit him on the nose. When he "sacrifices" the freely chosen decisions of the business community to use their economic freedom and freedom of association to amalgamate into large units, he is doing the *opposite* of "preserv[ing] more economic freedom." To think that this is a way of defending economic freedom indicates only the more that Simons simply has no understanding of this concept.

What "powers," apart from limited liability, does Simons think are granted corporations? Surely, limited liability on the part of a corporate entity is well known enough to the general public that if someone did not want to deal with one of them, he would not be forced to do so.[75] And why should one corporation be prohibited from taking a position in another? To disallow this is to undermine the rights of private property, which Simons is on record as defending. That crack about large size being per se improper would be more appropriate coming from an avowed Marxist than from a member of the "free enterprise" Chicago economics department. This corporation bashing is symptomatic of died-in-the-wool leftists.[76] One would have thought that a University of Chicago economist would have been free from at least this anti-business prejudice. Unfortunately, not.

Marketing

Never is our indictment of Simons as a left liberal, not a free market advocate, on stronger ground than when it comes to marketing. In words eerily reminiscent of that other laissez-faire advocate, John K. Galbraith,[77] Simons writes:

> It is a commonplace that our vaunted efficiency in production is dissipated extravagantly in the wastes of merchandising. . . . Profits may be obtained either by producing

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[74]Simons, *Economic Policy for a Free Society*, p. 52.

[75]For an antidote to this know-nothing-ism attack on the corporate form of business, see Robert Hessen, *In Defense of the Corporation* (Stanford, Calif.: Hoover Institution Press, 1979).

[76]See, for example, A.A. Berle, Jr., and Gardner C. Means, *The Modern Corporation and Private Property* (New York: Commerce, 1932).

[77]John Kenneth Galbraith, *The Affluent Society* (Boston: Houghton-Mifflin, 1958).

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> what consumers want or by making consumers want what one is actually producing. The possibility of profitably utilizing resources to manipulate demand is, perhaps, the greatest source of diseconomy under the existing system. If present tendencies continue, we may soon reach a situation where most of our resources are utilized in persuading people to buy one thing rather than another, and only a minor fraction is actually employed in creating things to be bought. Firms must spend enormous sums on advertising, if only to counteract the expenditures of competitors; and finally, all of them may end up with about the same volume of business as if none had advertised at all.[78]

Could it be that we have discovered the inspiration for Galbraith's attack on advertising?

A moment's reflection will disabuse us of the idea that there is any rationale in this view. First, if advertising is prohibited, this will give an unfair advantage to those firms already in business vis-a-vis start-up companies. After all, the former are already known, and the latter are not. Without aggressive marketing of the sort the former previously enjoyed, it will be impossible to launch any of the latter.

Second, evidence indicates that rather than keeping all companies on the same even keel that would have obtained had there been no advertising, the practice of advertising is actually associated with lower prices, due to economies of scale.[79]

Third, this "dependence effect" argument is dead from the neck up.[80] Of course people have to be introduced to new products; no one comes in to the world, for example, with a demand for Mozart, or shoes for that matter. If consumers are not made aware of these products, e.g., "making consumers want what one is actually producing,"[81] they will have to do without them.

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[78]Simons, *Economic Policy for a Free Society*, p. 71.

[79]Lee Benham, "The Effect of Advertising on the Price of Eyeglasses," *Journal of Law and Economics* 15 (October 1972).

[80]F.A. Hayek, "The Non Sequitur of the 'Dependence Effect'," in *Studies in Philosophy, Politics, and Economics* (New York: Simon and Schuster, 1967).

[81]Again, Simons fails to sufficiently distinguish coercion from non-coercion. "Making" consumers purchase what you are producing sounds perilously close to going out and threatening them with physical violence if they do not make the purchases you wish they would. Nothing could be further from the truth.

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Fourth, advertising is much more prevalent than is appreciated in Simons's philosophy. Every time a girl applies make-up, or a boy brushes his hair, they are advertising themselves in the marriage market. Whenever Simons himself, if truth be told, put on a suit and tie, he was engaged in the nefarious business of fooling people into believing he was more powerful, intelligent, etc., than he really was.[82]

Last but by no means least, the aphorism in the bathrooms of the nation attest that "the job's not finished until the paper work is done." In commerce, the job is not over when the item is manufactured or produced. Until it is in the hand of the consumer, it might as well not have been produced at all, for all the good it can do; it is still merely part of inventory. Merchandising is not merely a frippery, added on to the true task of production.[83] In a real sense, it is the essence of the production process.

Conclusion

Although a case can be made on the basis of his views on fractional-reserve banking, price controls, and the Hoover New Deal that Simons is a representative of the libertarian, or classical liberal, or free-enterprise school of thought, this claim is totally vitiated by his views on numerous other issues. We have examined his analyses of free trade, freedom of association, anti-trust, taxation, money, egalitarianism, federalism, coercion, private property, socialism, and labor unions, and have found them incompatible with this political economic philosophy. Rather, they are typical of a leftist, a moderate socialist, or a member of the right wing of the Democratic Party. Moreover, we have looked at his goals for public policy and have found them to be yet another example of the wide disparity between his views and those of free-market advocates. His attempt to redefine the nature of laissez-faire capitalism indicates that he realizes just how wide and unbridgeable a gap exists between him and this perspective. Rather than attempt to bridge it by withdrawing some of his more extreme socialistic views, he tries to bridge it by changing the rule of the game in midstream. Nor do his perspectives on corporations and marketing cause us to change this assessment.

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[82]Walter Block, *Defending the Undefendable* (New York: Fox and Wilkes, 1991), pp. 68–79.

[83]Israel M. Kirzner, *Competition and Entrepreneurship* (Chicago: University of Chicago Press, 1973).

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It would be a fascinating question to determine how such a leftist could attain a reputation as a rightist. It would be informative to learn why he felt the need to hide his views—which do, concededly, have a thin veneer of pro-market sentiment—under the banner of laissez faire. But these are questions for another day.

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MILTON FRIEDMAN UNRAVELED

Murray N. Rothbard*

Mention "free-market economics" to a member of the lay public and chances are that if he has heard the term at all, he identifies it completely with the name Milton Friedman. For several years, Professor Friedman has won continuing honors from the press and the profession alike, and a school of Friedmanites and "monetarists" has arisen in seeming challenge to the Keynesian orthodoxy.

However, instead of the common response of reverence and awe for "one of our own who has made it," libertarians should greet the whole affair with deep suspicion: "If he's so devoted a libertarian, how come he's a favorite of the Establishment?" An advisor of Richard Nixon and a friend and associate of most Administration economists, Friedman has, in fact, made his mark in current policy, and indeed reciprocates as a sort of leading unofficial apologist for Nixonite policy.

In fact, in this as in other such cases, suspicion is precisely the right response for the libertarian, for Professor Friedman's particular brand of "free-market economics" is hardly calculated to ruffle the feathers of the powers-that-be. Milton Friedman is the Establishment's Court Libertarian, and it is high time that libertarians awaken to this fact of life.

THE CHICAGO SCHOOL

Friedmanism can be fully understood only in the context of its historical roots, and these roots are the so-called "Chicago School" of

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economics of the 1920s and 1930s. Friedman, a professor at the University of Chicago, is now the undisputed head of the modern, or second-generation, Chicago School, which has adherents throughout the profession, with major centers at Chicago, UCLA, and the University of Virginia.

The members of the original, or first-generation, Chicago School were considered "leftish" in their day, as indeed they were by any sort of genuine free-market criterion. And while Friedman has modified some of their approaches, he remains a Chicago man of the thirties.

The political program of the original Chicagoans is best revealed in the egregious work of a founder and major political mentor: Henry C. Simons's *A Positive Program for Laissez Faire*.[1] Simons's political program was *laissez faire*ist only in an unconsciously satiric sense. It consisted of three key ideas:

(1) a drastic policy of trust-busting of all business firms and unions down to small blacksmith-shop size, in order to arrive at "perfect" competition and what Simons conceived to be the "free market";

(2) a vast scheme of compulsory egalitarianism, equalizing incomes through the income-tax structure; and

(3) a proto-Keynesian policy of stabilizing the price-level through expansionary fiscal and monetary programs during a recession.

Extreme trust-busting, egalitarianism, and Keynesianism: the Chicago School contained within itself much of the New Deal program, and, hence, its status within the economics profession of the early 1930s as a leftish fringe. And while Friedman has modified and softened Simons's hard-nosed stance, he is still, in essence, Simons *redivivus*; he only *appears* to be a free-marketeer because the remainder of the profession has shifted radically leftward and stateward in the meanwhile. And, in some ways, Friedman has added unfortunate statists elements that were not even present in the older Chicago School.[2]

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[1]Henry C. Simons, *A Positive Program for Laissez Faire: Some Proposals for a Liberal Economic Policy* (Chicago: University of Chicago Press, 1934).

[2]In this article, I am confining discussion to the politico-economic, and omitting the technical problems of economic theory and methodology. It is in the latter where Friedman has been at his worst, for Friedman has managed to change the older Chicagoan methodology, in its essence Aristotelian and rationalist, to an egregious and extreme variant of positivism.

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The Chicago School on Monopoly and Competition

Let us take the leading elements of Simonsian collectivist *laissez faire* in their turn. On monopoly and competition, Friedman and his colleagues have happily come a long way toward rationality from the old ultra-trust-busting of Simons. Friedman now concedes that the *major* source of monopoly in the economy is the activity of government, and focuses on repeal of these monopolizing measures.

The Chicagoans have gotten progressively more friendly to large business operating on the free market, and such Friedmanites as Lester Telser have even emerged with excellent arguments on behalf of advertising, previously anathema to all "perfect competitionists." But while in practice Friedman has become more libertarian on the monopoly question, he still retains the old Chicagoite theory: that in some way, the absurd, unreal, and unfortunate world of "perfect competition" (a world in which every firm is so minute that nothing it does can affect its demand and the price of its products) is *better* than the real, existing world of competition, which is dubbed "imperfect."

An infinitely superior view of competition is found in the totally neglected school of "Austrian economics" which scorns the "perfect competition" model and prefers the real world of free-market competition.[3] So while Friedman's practical view of competition and monopoly is not too bad, the weakness of his underlying theory could permit at any time a return to the frenetic trust-busting of the Chicagoans of the 1930s. It was not very long ago, for example, that Friedman's most distinguished associate, Professor George J. Stigler, advocated before Congress the trust-busting break-up of U.S. Steel into many constituent parts.

Friedman's Chicagoite Egalitarianism

While Friedman has abandoned Simons's call for extreme egalitarianism through the income tax structure, the basic lineaments of statist egalitarianism still remain. It remains in the Chicagoite desire to lay the tax structure's greatest stress on the income tax, undoubtedly the most totalitarian of all taxes. Chicagoites prefer the income tax because, in their economic theory, they follow the disastrous tradition of orthodox Anglo-American economics in sharply separating the "microeconomic" from the "macroeconomic" spheres.

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[3]For an excellent introduction to the Austrian view, see of F.A. Hayek, *Individualism and the Economic Order* (Chicago: University of Chicago Press, 1948), chap. 5.

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The idea is that there are two sharply separated and independent worlds of economics. On the one hand, there is the "micro" sphere, the world of individual prices determined by the forces of supply and demand. Here, the Chicagoans concede, the economy is best left to the unhampered play of the free market. But, they assert, there is also a separate and distinct sphere of "macro" economics, of economic aggregates of government budget and monetary policy, where there is no possibility or even desirability of a free market.

In common with their Keynesian colleagues, the Friedmanites wish to give to the central government absolute control over these macro areas, in order to manipulate the economy for social ends, while maintaining that the micro world can still remain free. In short, Friedmanites as well as Keynesians concede the vital macro sphere to statism as the supposedly necessary framework for the micro-freedom of the free market.

In reality, the macro and micro spheres are integrated and intertwined, as the Austrians have shown. It is impossible to concede the macro sphere to the State while attempting to retain freedom on the micro level. Any sort of tax, and the income tax not least of all, injects systematic robbery and confiscation into the micro sphere of the individual, and has unfortunate and distortive effects on the entire economic system. It is deplorable that the Friedmanites, along with the rest of Anglo-American economics, have never paid attention to the achievement of Ludwig von Mises, founder of the modern Austrian School, in integrating the micro and macro spheres in economic theory as far back as 1912 in his classic *The Theory of Money and Credit.*[4]

Milton Friedman has revealed his quintessential pro-income tax and egalitarian position in numerous ways. As in many other spheres, he has functioned *not* as an opponent of statism and advocate of the free market, but as a technician advising the State on how to be more efficient in going about its evil work. (From the viewpoint of a genuine libertarian, the more inefficient the State's operations, the better![5]) He has opposed tax exemptions and "loopholes" and worked to make the income tax more uniform.

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[4]Ludwig von Mises, *The Theory of Money and Credit*, trans. H.E Batson (Indianapolis, Ind.: Liberty Classics, 1980).

[5]There is a charming anecdote about the distinguished industrialist Charles F. Kettering. Visiting the hospital bed of a friend who was complaining about the growth of government, Kettering told him "Cheer up Jim. Thank God we don't get as much government as we pay for!"

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One of Friedman's most disastrous deeds was the important role he proudly played, during World War II in the Treasury Department, in foisting upon the suffering American public the system of the *withholding* tax. Before World War II, when income tax rates were far lower than now, there was no withholding system; everyone paid his annual bill in one lump sum, on March 15. It is obvious that under this system, the Internal Revenue Service could never hope to extract the entire annual sum, at current confiscatory rates, from the mass of the working population. The whole ghastly system would have happily broken down long before this. Only the Friedmanite withholding tax has permitted the government to use every employer as an unpaid tax collector, extracting the tax quietly and silently from each paycheck. In many ways, we have Milton Friedman to thank for the present monster Leviathan State in America.

In addition to the income tax itself, Friedman's egalitarianism is revealed in the Friedman-Stigler pamphlet attacking rent controls. "For those, like us, who would like even more equality than there is at present . . . it is surely better to attack directly the existing inequalities in income and wealth at their source" than to restrict the purchases of particular commodities, like housing.[6]

The single most disastrous influence of Milton Friedman has been a legacy from his old Chicagoite egalitarianism: the proposal for a guaranteed annual income to everyone through the income tax system—an idea picked up and intensified by such leftists as Robert Theobald, and one which President Nixon will undoubtedly be able to ram through the new Congress.[7*]

In this catastrophic scheme, Milton Friedman has once again been guided by his overwhelming desire *not* to *remove* the State from our

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[6]Milton Friedman and George J. Stigler, *Roofs or Ceilings?* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1946), p. 10.

[7]For a further critique of the Friedman-Nixon guaranteed income doctrine, see Murray N. Rothbard, "The Guaranteed Annual Income," *The Rational Individualist* (September 1969); and Henry Hazlitt, *Man vs. The Welfare State* (New Rochelle, N.Y.: Arlington House, 1969), pp. 62–100.

*Rothbard correctly predicted that this Friedman proposal would be part of the 1972 presidential campaign. Interestingly, and tellingly, it was proposed by Nixon's Democrat opponent, Senator George McGovern. Voters considered it to be extremely radical, and McGovern was overwhelmingly defeated.—Ed.

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lives, but to make the State more efficient. He looks around at the patchwork mess of local and state welfare systems, and concludes that all would be more efficient if the whole plan were placed under the federal income tax rubric and everyone were guaranteed a certain income floor. More efficient, perhaps, but also far more disastrous, for the only thing that makes our present welfare system even tolerable is precisely its *in*efficiency, precisely the fact that in order to get on the dole one has to push one's way through an unpleasant and chaotic tangle of welfare bureaucracy. The Friedman scheme would make the dole *automatic*, and thereby give everyone an automatic claim upon production.

Welfare's "Supply Function"

We have to realize that being on welfare is *not*, as most people believe, a simple and absolute act of God or nature, a stark *given* like a volcanic eruption. Being-on-welfare, like all other human economic acts, has a "supply function": in other words, if you make welfare pay enough, you can produce as many welfare clients as you wish to have. Pay them little enough and you can reduce the number of clients at will. In short, if the government should announce that anyone who signs up at a "welfare" desk gets an automatic annual check of $40,000 for as long as he wishes, we will find soon enough that almost everyone has become a welfare recipient—and what is more, will join a "welfare rights" organization to lobby for $60,000 to offset the rise in the cost of living.

More specifically, the supply function of welfare clients is inversely proportion to the difference between the *prevailing wage rate* in the area and the *level of welfare payments*. This difference is the "opportunity cost" of going on welfare—the amount that one loses by loafing instead of working. If, for example, the prevailing wage rises in an area and the welfare payments remain the same, the differential and the "opportunity cost" of loafing rise, and people tend to leave the welfare dole and go to work. If the opposite happens, more people will go on the dole. If being on welfare were an absolute fact of nature, then there would be no relation between this differential and the number on welfare.[8]

[8]For an empirical demonstration of this relationship, see C.T. Brehm and T.R. Saving, "The Demand for General Assistance Payments," *American Economic Review* 54, no. 6 (December 1964), pp. 1002–18.

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Secondly, the supply of welfare clients is inversely proportion to another vitally important factor: the cultural or value disincentive of going on welfare. If this disincentive is strong, if, for example, an individual or group strongly believes that it is *evil* to go on welfare, they will not do it, period. If, on the other hand, they do not care about the stigma of welfare, or, worse yet, they regard welfare payments as their *right*—a right to exert a compulsory, looting claim upon production—then the number of people on welfare will increase astronomically, as has happened in recent years.

There are several recent examples of the "stigma effect." It has been shown that, given the same level of income, more people tend to go on welfare in urban than in rural areas, presumably as a function of the greater *visibility* of welfare clients and hence the greater stigma in the more sparsely populated region. More important, there is the glowing fact that certain religious groups, even when significantly poorer than the rest of the population, simply do *not* go on welfare because of their deeply held ethical beliefs. Thus, the Chinese-Americans, while largely poor, are almost never to be found on welfare. A recent article on Albanian-Americans in New York City highlights that same point. These Albanians are invariable poor slum dwellers, and yet there is no Albanian-American on welfare. Why? Because, said one of their leaders, "Albanians do not beg, and to Albanians, taking welfare is like begging in the street."[9]

Another example is the Mormon Church, very few of whose members are on public welfare. For the Mormons not only inculcate in their members the virtues of thrift, self-help, and independence, they also take care of their own needy through church charity programs which are grounded on the principle of *helping people to help themselves*, and thereby getting them off charity as quickly as possible.[10] Thus, the Mormon Church counsels its members that "to seek and accept direct public relief all too often invites the curse of idleness

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[9]*New York Times* (April 13, 1970).

[10]This was the same principle as the one guiding the Charity Organization Society in nineteenth-century England. That classical-liberal organization "believed that the most serious aspect of poverty was the degradation of the character of the poor man or woman. Indiscriminate charity only made things worse; it demoralized. True charity demanded friendship, thought, the sort of help that would restore a man's self-respect and his ability to support himself and his family." Charles Loch Mowat, *The Charity Organization Society* (London: Methuen, 1961), p. 2.

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and fosters the other evils of dole. It destroys one's independence, industry, thrift, and self-respect."[11] Hence, the Church's highly successful private welfare program is based on the principles that

> the Church has encouraged its members to establish and maintain their economic independence: it has encouraged thrift and foster the establishment of employment-creating industries; it has stood ready at all times to help needy faithful members.

And:

> Our primary purpose was to set up, in so far as it might be possible, a system under which the curse of idleness would be done away with, the evils of a dole abolished, and independence, industry, thrift, and self-respect be once more established among our people. The aim of the Church is to help the people help themselves. Work is to be re-enthroned as the ruling principles of the lives of our Church membership. . . . Faithful to this principle, welfare workers will earnestly teach and urge Church members to be self-sustaining to the full extent of their powers. No true latter-day Saint will, while physically able, voluntarily shift from himself the burden of his own support.[12]

The Libertarian approach to the welfare problem, then, is to abolish all coercive, public welfare, and to substitute for it private charity based on the principle of encouraging self-help, bolstered also by inculcating the virtues of self-reliance and independence throughout society.

Incentives under the Friedman Plan

But the Friedman plan, on the contrary, moves in precisely the *opposite* direction, for it establishes welfare payments as an automatic *right*, an automatic, coercive claim upon the producers. It thereby removes the stigma effect altogether, disastrously discourages productive work by steep taxation, and by establishing a guaranteed income for not working, which encourages loafing. In addition, by establishing an income floor as a coercive "right," it encourages welfare clients to lobby for ever-higher floors, thus continually aggravating the entire problem. But Friedman, caught in the Anglo-American separation of "micro"

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[11] *Welfare Plan of the Church of Jesus Christ of Latter-Day Saints* (The General Church Welfare Committee, 1960), p. 48.

[12] *Welfare Plan*, pp. 1–2.

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and "macro," gives very little attention to these cataclysmic effects on incentives.

Even the handicapped are hampered by the Friedmanite plan, for an automatic dole removes the marginal incentive for the handicapped worker to invest in his own vocational rehabilitation, since the net monetary return from such investment is now greatly lowered. Hence, the guaranteed income tends to *perpetuate* these handicaps. Finally, the Friedmanite dole would pay a higher income *per person* to welfare families, thereby subsidizing a continuing increase in the child population among the poor—precisely those who can least afford such a population growth. Without joining in the current hysteria about the "population explosion," it is certainly absurd to deliberately subsidize the breeding of more pauper-children, which is what the Friedman plan would do as an *automatic right*.

Money and the Business Cycle

The third major feature of the New Deal program was proto-Keynesian: the planning of the "macro" sphere by the government in order to iron out the business cycle. In his approach to the entire area of money and the business cycle—an area on which unfortunately Friedman has concentrated most of his efforts—Friedman harks back not only to the Chicagoans, but, like them, to Yale economist Irving Fisher, who was *the* Establishment economist from the 1900s through the 1920s. Friedman, indeed, has openly hailed Fisher as the "greatest economist of the twentieth century," and when one reads Friedman's writings, one often gets the impression of reading Fisher all over again, dressed up, of course, in a good deal more mathematical and statistical mumbo-jumbo. Economists and the press, for example, have been hailing Friedman's recent "discovery" that interest rates tend to rise as prices rise, adding an inflation premium to keep the "real" rate of interest the same; this ignores the fact that Fisher had pointed this out at the turn of the twentieth century.

But the key problem with Friedman's Fisherine approach is the same orthodox separation of the micro and macro spheres that played havoc with his views on taxation. For Fisher believed, again, that on the one hand there is a world of individual prices determined by supply and demand, but on the other hand there is an aggregate "price level" determined by the supply of money and its velocity of turnover, and never the twain do meet. The aggregate, macro, sphere is supposed to be the fit subject of government planning and manipulation, again

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supposedly without affecting or interfering with the micro area of individual prices.

Fisher on Money

In keeping with this outlook, Irving Fisher wrote a famous article in 1923, "The Business Cycle Largely a 'Dance of the Dollar'"—recently cited favorably by Friedman—which set the model for the Chicagoite "purely monetary" theory of the business cycle. In this simplistic view, the business cycle is supposed to be merely a "dance," in other words, an essentially random and causally unconnected series of ups and downs in the "price level." The business cycle, in short, *is* random and needless variations in the aggregate level of prices. Therefore, since the free market gives rise to this random "dance," the cure for the business cycle is for the government to take measures to *stabilize* the price level, to keep that level constant. This became the aim of the Chicago School of the 1930s, and remains Milton Friedman's goal as well.

Why is a stable price level supposed to be an ethical idea, to be attained even by the use of governmental coercion? The Friedmanites simply take the goal as self-evident and scarcely in need of reasoned argument. But Fisher's original groundwork was a total misunderstanding of the nature of money, and of the names of various currency units. In reality, as most nineteenth century economists knew full well, these names (dollar, pound, franc, etc.) were not somehow realities in themselves, but were simply names for units of weight of gold or silver. It was these commodities, arising in the free market, that were the genuine moneys; the names, and the paper money and bank money, were simply claims for payment in gold or silver. But Irving Fisher refused to recognize the true nature of money, or the proper function of the gold standard, or the name of a currency as a unit of weight in gold. Instead, he held these names of paper money substitutes issued by the various governments to be absolute, to *be* money. The function of this "money" was to "measure" values. Therefore, Fisher deemed it necessary to keep the purchasing power of currency, or the price level, constant.

This quixotic goal of a stable price level contrasts with the nineteenth-century economic view—and with the subsequent Austrian School. They hailed the results of the unhampered market, of *laissez faire* capitalism, in invariably bringing about a steadily *falling* price level. For without the intervention of government, productivity and

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the supply of goods tends always to increase, causing a decline in prices. Thus, in the first half of the nineteenth century—the "Industrial Revolution"—prices tended to fall steadily, thus raising the real wage rates even without an increase of wages in money terms. We can see this steady price decline bringing the benefits of higher living standards to *all* consumers, in such examples as TV sets falling from $2000 when first put on the market to about $100 for a far better set. And this in a period of galloping inflation.

It was Irving Fisher, his doctrines, and his influence, which was in large part responsible for the disastrous inflationary policies of the Federal Reserve System during the 1920s, and therefore for the subsequent holocaust of 1929. One of the major aims of Benjamin Strong, head of the Federal Reserve Bank (Fed) of New York and virtual dictator of the Fed during the 1920s, was, under the influence of the Fisher doctrine, to keep the price level constant. And since wholesale prices were either constant or actually falling during the 1920s, Fisher, Strong, and the rest of the economic Establishment *refused to recognize* that an inflationary problem even existed. So, as a result, Strong, Fisher, and the Fed refused to heed the warnings of such heterodox economists as Ludwig von Mises and H. Parker Willis during the 1920s that the unsound bank credit inflation was leading to an inevitable economic collapse. So pig-headed were these worthies that, as late as 1930, Fisher, in his swansong as economic prophet, wrote that there was no depression, and that the stock market collapse was only temporary.[13]

Friedman on Money

And now, in his highly touted *Monetary History of the United States*, Friedman his demonstrated his Fisherine bias in interpreting American economic history.[14] Benjamin Strong, undoubtedly the single most disastrous influence upon the economy of the 1920s, is lionized by Friedman precisely for his inflation and price-level stabilization during that decade.[15] In fact, Friedman attributes the 1929

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[13]Irving Fisher, *The Stock Market Crash—And After* (New York: Macmillan, 1930).

[14]Milton Friedman and Anna Schwartz, *A Monetary History of the United States, 1867–1960* (Princeton, N.J.: Princeton University Press, 1963).

[15]See Murray N. Rothbard, *America's Great Depression* (Princeton, N.J.: D. Van Nostrand, 1963), for a contrasting view of the 1920s. More on the Friedmanite vs. Austrian view of the business cycle can be found in Murray N.

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depression *not* to the preceding inflation boom but to the failure of the post-Strong Federal Reserve to inflate the money supply *enough* before and during the depression.

In short, while Milton Friedman has performed a service in bringing back to the notice of the economics profession the overriding influence of money and the money supply on business cycles, we must recognize that this "purely monetarist" approach is almost the exact *reverse* of the sound—as well as truly free-market—Austrian view. For while the Austrians hold that Strong's monetary expansion made a later 1929 crash inevitable, Fisher-Friedman believe that all the Fed needed to do was to pump *more* money in to offset any recession. Believing that there is no causal influence running from boom to bust, believing in the simplistic "Dance of the Dollar" theory, the Chicagoites simply want government to manipulate that dance, specifically to increase the money supply to offset recession.

During the 1930s, therefore, the Fisher-Chicago position was that, in order to cure the depression, the price level needed to be "reflated" back to the levels of the 1920s, and that reflation should be accomplished by:

(1) the Fed expanding the money supply, and

(2) the Federal government engaging in deficit spending and large-scale public works programs.

In short, during the 1930s, Fisher and the Chicago School were "pre-Keynes Keynesians," and were, for that reason, considered quite radical and socialistic—and with good reason. Like the later Keynesians, the Chicagoans favored a "compensatory" monetary and fiscal policy, though always with greater stress on the monetary arm.

Some might object that Milton Friedman does not believe so much in a manipulative monetary and fiscal policy as in an "automatic" increase by the Federal Reserve at a rate of 3–4 percent per year. But this modification of the older Chicagoans is purely a technical one, stemming from Friedman's realization that day-to-day, short-term manipulations by the Fed will suffer from inevitable time lags, and are therefore bound to aggravate rather than ameliorate the cycle. But we must realize that Friedman's automatic inflationist policy is simply another variant in his pursuit of the same old Fisherine-Chicagoite

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Rothbard, "The Great Inflationary Recession Issue: 'Nixonomics' Explained," *The Individualist* (June 1970), pp. 1–5.

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aim: stabilization of the price level—in this case, stabilization *over the long run*.

Thus, Milton Friedman is, purely and simply, a statist-inflationist, albeit a more moderate inflationist than most of the Keynesians. But that is small consolation indeed, and hardly qualifies Friedman as a free-market economist in this vital area.

Fisher, Friedman, and the End of the Gold Standard

From his earliest days, Irving Fisher was—properly—considered to be a monetary radical and a statist for his desire to scrap the gold standard. Fisher realized that the gold standard—under which the basic money is a commodity mined on the free market rather than created by government—was incompatible with his overpowering desire to stabilize the price level. Hence, Fisher was one of the first modern economists to call for the abolition of the gold standard and its replacement by fiat money.

Under a fiat system, the currency *name*—dollar, frank, mark, etc. —*becomes* the ultimate monetary standard, and absolute control over the supply and use of these units is necessarily vested in the central government. In short, fiat currency is inherently the money of absolute statism. Money is the central commodity, the nerve center, as it were, of the modern market economy, and any system that vests the absolute control of that commodity in the hands of the State is hopelessly incompatible with a free-market economy or, ultimately, with individual liberty itself.

Yet, Milton Friedman is a radical advocate of cutting all current ties, however weak, with gold, and going onto a total and absolute fiat dollar standard, with all control vested in the Federal Reserve System.* Of course, Friedman would then *advise* the Fed to use that absolute power wisely, but no libertarian worth the name can have anything but contempt for the very idea of vesting coercive power in any group and then *hoping* that such group will not use its power to the utmost. The reasons that Friedman is totally blind to the tyrannical and despotic implications of his fiat money scheme is, once again, the arbitrary Chicagoite separation between the micro and the macro, the vain, chimerical hope that we can have totalitarian control of the macro sphere while

*This is, in fact, exactly what happened within a few years of this article's original publication. See Murray N. Rothbard, *What Has Government Done To Our Money?* (Auburn, Ala.: Ludwig von Mises Institute, 1990).—Ed.

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the "free market" is preserved in the micro. It should be clear by now that this kind of a truncated, Chicagoite micro-"free market" is "free" only in the most mocking and ironic sense: it is far more the Orwellian "freedom" of "Freedom is Slavery."

A Return to the Gold Standard

There is no question about the fact that the present international monetary system is an irrational and abortive monstrosity, and needs drastic reform. But Friedman's proposed reform, of cutting all ties with gold, would make matters far worse, for it would leave everyone at the complete mercy of his own fiat-issuing state. We need to move precisely in the opposite direction: to an international gold standard that would restore commodity money everywhere and get all the money-manipulating states off the backs of the peoples of the world.

Furthermore, gold, or some other commodity, is vital for providing an *international money*—a basic money in which all nations can trade and settle their accounts. The philosophical absurdity of the Friedmanite plan of each government providing its own fiat money, cut loose from all others, can be seen clearly if we consider what would happen if every region, every province, every state, nay every borough, county, town, village, *block, house, or individual* would issue its own money, and we then had, as Friedman envisions, freely fluctuating exchange rates between all these millions of currencies. The ensuing chaos would stem from the destruction of the very concept of *money*—the entity that serves as a general medium for all exchanges on the market. Philosophically, Friedmanism would destroy money itself, and reduce us to the chaos and primitivism of the barter system.

One of Friedman's crucial errors in his plan of turning all monetary power over to the State is that he fails to understand that this scheme would be inherently inflationary. For the State would then have in its complete power the issuance of as great a supply of money as it desired. Friedman's advice to restrict this power to an expansion of 3–4% per year ignores the crucial fact that *any* group, coming into the possession of the absolute power to "print money," will tend to . . . print it! Suppose that John Jones is granted by the government the absolute power, the compulsory monopoly, over the printing press, and allowed to issue as much money as he sees fit, and to use it in any way that he sees fit. Isn't it crystal clear that Jones will use this power of *legalized counterfeiting* to a fare-thee-well, and therefore that his rule over money will tend to be inflationary? In the same way, the State has long

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arrogated to itself the compulsory monopoly of legalized counterfeiting, and so it has tended to use it: hence, the State is *inherently inflationary*, as would be any group with the sole power to create money. Friedman's scheme would only intensify that power and that inflation.

The only *libertarian* solution, in contrast, is to make the State disgorge its hoards of commodity money. Franklin Roosevelt, under cover of a "depression emergency," confiscated all of the gold held by the American people in 1933, and nothing has been said for nearly four decades about giving our gold back. In contrast to Friedman, the genuine libertarian must call upon the government to give the people back their stolen gold, which the government had seized from us in return for its paper dollars.

NEIGHBORHOOD EFFECTS

Thus, in the two vital macro fields of taxation and money, Milton Friedman's influence has been enormous—far greater than in any other area—and almost uniformly disastrous from the point of view of a genuinely free market. But even on the micro level, where his influence has been smaller and usually more beneficial, Friedman has provided to interventionists a theoretical loophole as wide as a barn door. For Friedman maintains that it is legitimate for the government to interfere with the free market whenever anyone's actions have "neighborhood effect." Thus, if A does something which will benefit B, and B does not have to pay for it, Chicagoites consider this a "defect" in the free market, and it then becomes the task of government to "correct" that defect by taxing B to pay A for this "benefit."

It is for this reason that Friedman endorses government supplying funds for mass education, for example; since the education of kids is supposed to benefit other people, then the government is allegedly justified in taxing these people to pay for these "benefits." (Once again, in this area, Friedman's pernicious influence has been in trying to make an inefficient State operation far more efficient; here he suggests replacing unworkable public schools by public voucher payments to parents—thus leaving intact the whole concept of tax-funds for mass education.)

Apart from the vitally important realm of education, Friedman would, in practice, limit the neighborhood effects argument to such measures as urban parks. Here, Friedman is worried that if the parks were private, someone might enjoy looking at one from afar and not

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be forced to pay for this psychic benefit. Hence, he advocates public *urban* parks only. *Rural* parks, he feels, can be private for they can be secluded enough to force all users to pay for services rendered.

It is small comfort that Friedman himself would confine this neighborhood-effects argument to a few instances, such as education and urban parks. In reality, this argument could be used to justify almost any intervention, and subsidy and tax scheme. I, for example, read Mises's *Human Action*; I therefore imbibe more wisdom and become a better person; by becoming a better person, I benefit my fellow man; yet, hang it, they are not being forced to pay for those benefits! Shouldn't the government tax these people and subsidize me for being so worthy as to read *Human Action*?

Or, to take another example, whether Women's Libbers like it or not, many men obtain a great deal of enjoyment from watching girls in mini-skirts; yet, these men are not paying for this enjoyment. Here is another neighborhood effect remaining uncorrected! Shouldn't the men of this country be taxed in order to subsidize girls to wear mini-skirts?

There is no point in multiplying examples; they proliferate almost endlessly, and expose the total absurdity and the pervasiveness of Chicagoite neighborhood-effect concessions to statism. The only reply that Chicagoites have been able to make to this *reductio ad absurdum* is that *they* wouldn't carry government intervention that far, though they concede the logic. But why not? By what standard, by what criterion, do *they* stop at parks and schools? The point is that there is no such criterion, and this only points up the intellectual bankruptcy, the lack of logical rigor, at the core of most current-day economics and social science—Friedmanism included.

THE IMPACT OF FRIEDMAN

And so, as we examine Milton Friedman's credentials to be *the* leader of free-market economics, we arrive at the chilling conclusion that it is difficult to consider him a free-market economist at all. Even in the micro sphere, Friedman's theoretical concessions to the egregious ideal of "perfect competition" would permit a great deal of governmental trust-busting, and his neighborhood-effect concession to a government intervention could permit a virtual totalitarian state, even though Friedman illogically confines its application to a few areas. But even here, Friedman uses this argument to justify the State's provision of mass education to everyone.

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But it is in the macro sphere, unwisely hived off from the micro by economists who remain after sixty years ignorant of Ludwig von Mises's achievement in integrating them, it is here that Friedman's influence has been at its most baleful. For we find Friedman bearing heavy responsibility both for the withholding tax system and for the disastrous guaranteed annual income looming on the horizon. At the same time, we find Friedman calling for absolute control by the State over the supply of money—a crucial part of the market economy. Whenever the government has, fitfully and almost by accident, stopped increasing the money supply (as Nixon did for several months in the latter half of 1969), Milton Friedman has been there to raise the banner of inflation once again. And wherever we turn, we find Milton Friedman, proposing not measures on behalf of liberty, not programs to whittle away the Leviathan State, but measures to make the power of that State more efficient, and hence, at bottom, more terrible.

The libertarian movement has coasted far too long on the intellectually lazy path of failing to make distinctions, or failing to discriminate, of failing to make a rigorous search to distinguish truth from error in the views of those who claim to be its members or allies. It is almost as if any passing joker who mumbles a few words about "freedom" is automatically clasped to our bosom as a member of the one, big, libertarian family. As our movement grows in influence, we can no longer afford the luxury of this intellectual sloth. It is high time to identify Milton Friedman for what he really is. It is high time to call a spade a spade, and a statist a statist.

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GEORGE STIGLER AND THE MYTH OF EFFICIENT GOVERNMENT

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George Stigler took the Chicago School's "perfect markets" model to its logical extreme when, in a 1992 article in the *Journal of Law and Economics,* he declared that

1) politics is just another market, complete with "buyers and sellers of legislation," and
2) all long-lived governmental institutions are therefore "efficient" by virtue of their having survived for a long time.[1]

Another Chicago School scholar, Donald Wittman, goes even further, calling government failure a "myth" and asserting that democratic government unequivocally promotes the welfare of all citizens.[2] The free market may never meet the perfectly competitive ideal but democratic government, to these two scholars, is Pareto optimal.

This article argues that while there are a few transparent similarities between politics and markets, the fundamental differences between them render the Stigler-Wittman view that politics is "just another market," and therefore always "efficient," dubious at best. Markets are not perfect in any neoclassical sense (nor is anything else on earth, for that matter), and neither is democracy. The Stigler-Wittman view is based on a false view of how both markets and governments operate and also suffers from being ahistorical.

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[1]George Stigler, "Law or Economics?" *Journal of Law and Economics* 35 (October 1992), pp. 455–68.

[2]Donald Wittman, *The Myth of Democratic Failure* (Chicago: University of Chicago Press, 1995).

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EFFICIENT GOVERNMENT?

Stigler may have had a reputation as a free-market champion of individualism but, ironically, his argument about "efficient" government was based on methodological collectivism. Rather than examining the behavior of individual actors, even in their roles as members of political interest groups, Stigler posited that "society," not individual decision makers, makes political choices.

> [I]n policy analysis, one may legitimately employ an alternative definition of efficiency that rests on the goals adopted by the society through its government. When a society wishes, for example, to give more income to a group than the market provides, we may surely analyze the efficiency with which this is done. In this . . . view, every durable social institution or practice is efficient, or it would not persist over time.[3]

This means that all common *and statute law* "must be efficient."[4] Stigler's Exhibit A in his catalogue of "efficient" government programs is the sugar price support program, which at the time (1992) was responsible for the transfer of more than $3 billion annually from sugar consumers to a small handful of politically-influential sugar-growing corporations. The program was necessarily efficient, said Stigler, because it had met the test of time: it had been around for 50 years. In keeping with the Chicago tradition of empiricism, this would suggest that Soviet communism, which at the time of Stigler's article was 75 years old, was exactly 50 percent more efficient than the U.S. sugar price support program.[5]

India is the world's largest democracy and has maintained more or less the same socialist institutions for more than 50 years. By Stigler's

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[3]Stigler, "Law or Economics?" p. 459.

[4]Stigler, "Law or Economics?" p. 459. Research in law and economics casts doubt on the notion that even the common law is efficient, however. Paul Rubin and Martin Bailey have shown, for example, how tort lawyers have shaped modern product liability law *to benefit lawyers primarily,* and not even the victims of product liability problems. See Paul Rubin and Martin Bailey, "The Role of Lawyers in Changing the Law," *Journal of Legal Studies* 23 (June 1994). Peter Huber comes to a similar conclusion in his book, *Liability: The Legal Revolution and its Consequences* (New York: Basic Books, 1988).

[5]Stigler did not explicitly state that he was restricting his comments to democratic governments.

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(and Wittman's) standards, India is arguably the largest purveyor of governmental "efficiency" in the world. Slavery existed for over 80 years under American democracy, which would presumably make it 60 percent more efficient than the sugar program.

Stigler's model explicitly assumes that there is little or no agency problem—no separation of ownership from control—when it comes to the relationship between citizens and government. Goals are adopted by "society" through its government, and as long as those goals are pursued for a long time, they are necessarily "efficient." Moreover, the goals that government sets for us are said to be exceptionally "authoritative," even though no explanation is given by Stigler for the source of this authority.

Chicago School scholars accept competitive equilibrium as their ideal benchmark and, as such, they also accept the whole framework of welfare or market failure economics, including the supposed necessity of antitrust regulation. But in Stigler's model, there is no corresponding government failure: government is essentially perfectly competitive. Politicians faithfully pursue the goals of "society" in an efficient manner.

Stigler was obviously aware of the voluminous government failure or public choice literature, but his argument ignores it completely.[6]

Forced Labor and Efficient Government

Government power rests primarily on its use of threats, intimidation, coercion, violence, propaganda, and fraud. If one protests the wastefulness of the sugar price support program, Pentagon fraud, the welfare state, or anything else by refusing to file a tax return, for example, the result will at first be threatening letters, then intimidating demands for payment, and ultimately the use of armed force to confiscate the protester's assets or throw him into prison. The fact that citizens do not revolt and overthrow their governments very often

[6]Stigler published several articles in *Public Choice*, and included in his references two classics in the field, James Buchanan and Gordon Tullock, *The Calculus of Consent: Logical Foundations of Constitutional Democracy* (Ann Arbor: University of Michigan Press, 1962), and Anthony Downs, *An Economic Theory of Democracy* (New York: Harper, 1957), so he can hardly claim ignorance of this literature. Oddly, he does not discuss these works, or public choice in general, in the text of his article. Many of his references, in fact, seem to have no relation to the discussion in the text of his article.

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does not mean that they consent to being plundered. As David Hume once pointed out, the fact that a conscripted sailor does not jump overboard and commit suicide does not mean that he consents to being conscripted.[7]

Secession from the corrupt, rent-seeking society that is lorded over by the federal government can also be risky and life threatening, as the Southern Confederates learned more than 135 years ago. Although modern historians usually ignore it, the Confederate Constitution attempted to limit the domain of government much more than the U.S. Constitution did, by outlawing protectionist tariffs and the use of taxpayer funds for corporate subsidies, and by eliminating the General Welfare Clause of the U.S. Constitution, among other things.[8]

But protectionist tariffs, subsidies to railroad corporations, and central banking (which most Southern statesmen also opposed) were the keystones of the 1860 Republican Party platform. Consequently, Abraham Lincoln waged a bloody war in which one out of every four white Southerners between the ages of 20 and 40 was killed by the federal government in order to "save the Union." This phrase was Lincoln's euphemism for creating a centralized state that overthrew the smaller, more decentralized system of government that had been created by the American founding fathers.[9] The right of secession, which many of the founding fathers considered to be *the* principle of the Revolution of 1776, was destroyed, along with the Jeffersonian doctrine of states' rights as a check on the overreaching powers of the central government.

The Jeffersonian dictum enshrined in the Declaration of Independence that governments derive their just powers from the consent of the governed was essentially overturned by Lincoln's war. Southerners no longer consented to be governed by Washington, D.C., and they were forced into an association with that government at gunpoint. From

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[7]David Hume, "Of the Original Contract," in *Hume's Ethical Writings*, ed. A. MacIntyre and D. Hume (New York: Collier Books, 1965), p. 263.

[8]Thomas J. DiLorenzo, *The Real Lincoln: A New Look at Abraham Lincoln, His Agenda, and an Unnecessary War* (New York: Forum/Random House, 2002).

[9]Lincoln's position was always that his "paramount objective" was to "save the Union," even if he could do it without freeing a single slave. His only use of the slavery issue, he repeatedly stated, was as a propaganda tool in the service of his overriding objective, consolidating governmental power in Washington, D.C. by destroying the right of secession.

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that point on, the American government became more and more the master, rather than servant, of the people.

It is this kind of violence, force, and coercion that lies behind and supports "long-lived government programs." There were no long-lived income transfer programs prior to the War Between the States. By ignoring this history, the Stigler-Wittman theory of governmental efficiency implicitly assumes that forced labor (to pay taxes) is an efficiency-enhancing institution since that is what allows special-interest programs to last for decades despite their inefficiencies and injustices. Indeed, it is fair to say that forced labor is a *prerequisite* for Stigler's brand of governmental "efficiency."

Products or practices that last a long time in private markets can be said to be efficient in that they assist market participants in coordinating their plans better than any alternative arrangements. In government, the income-transfer programs that Stigler and Wittman think are "efficient" can only last if threats, intimidation, fraud, and violence are used to keep them in place. The fact that such tactics must be used is evidence of how grossly *inefficient* such acts of theft really are in the sense that they are *not* the kinds of institutions that assist individuals in plan coordination. If they were truly efficient, people would adopt them voluntarily.

THE ROLE OF PROPAGANDA

Government doesn't always resort to outright violence or threats of violence to maintain its powers; excessive use of such tactics could incite a revolution, as they have on occasion throughout history. Consequently, it also operates a massive fraud operation designed to perpetually pull the wool over the public's eyes.[10] Or, in the polite, euphemistic language of academic discourse, it "manipulates constitutional-level transaction costs."[11]

The average citizen is "rationally ignorant" of most governmental policy issues, increasingly so as the size and scope of government increases. The *Federal Register*, for example, contains more than 80,000 pages of fine-print regulations that affect every industry in America,

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[10]E.g., while hypocritically policing "consumer fraud" through the Federal Trade Commission, government itself is exempt from FTC regulation.

[11]Charlotte Twight, "Government Manipulation of Constitutional-Level Transaction Costs: A General Theory of Transaction-Cost Augmentation and the Growth of Government," *Public Choice* 56 (1988), pp. 131–52.

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and almost all aspects of our lives. No human could possibly possess knowledge of anything but a minuscule portion of such a monstrous document. Federal tax laws and regulations are just as voluminous. This suggests that it is quite absurd to believe that voters are actually voting for real changes in public policy. How could they be voting for changes in policy if they have no way of understanding what more than a minuscule fraction of government policy consists of?

It is not in the average citizen's financial interest to invest sufficient time to become well informed in any but a few areas of public policy. This gives special-interest groups—including government officials and employees themselves—the latitude to manipulate political outcomes in democracies in ways that benefit themselves *at the expense* of nearly everyone else, which is hardly an "efficient" outcome. More than 50 years ago, Joseph Schumpeter observed that:

> What we are confronted with in the analysis of political processes is largely not a genuine but a manufactured will. . . . So far as this is so, the will of the people is the product and not the motive power of the political process.[12]

The hoary welfare economics dictum that special-interest transfer payments should be considered to be efficient as long as, *in theory,* the winners can compensate the losers (i.e., taxpayers) is a red herring argument. No such compensation has ever occurred, and even if it had, it is not clear that it could ever be efficient by the criteria established by neoclassical economics.

Far from Stigler's (and Wittman's) implicit assumption of near perfect information among voters, real-world voters are, for the most part, grossly uninformed about what government is up to. To make matters worse, much of what they do "know" is self-serving propaganda that is repeatedly broadcast to them by government itself. Government spends billions of dollars attempting to persuade the public that policies that in reality only benefit a small special interest group, including the state itself, are really in "the public interest."

In *Official Lies: How Washington Misleads Us,* James Bennett and I detailed how institutionalized governmental lying pervades all areas of government policy.[13] In welfare policy, government statistics

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[12]Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper & Row, 1950), p. 263.

[13]James T. Bennett and Thomas J. DiLorenzo, *Official Lies: How Washington Misleads Us* (Alexandria, Va.: Groom Books, 1992).

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do not count cash and in-kind subsidies as part of the income of "the poor," nor does government subtract out taxes from the income of the more affluent when publishing its "income distribution" statistics. This allows it to perpetually complain about the "inequity" of capitalism and to advocate egalitarianism.

Farm subsidies go mostly to large corporate farms, although decades of propaganda have convinced millions of Americans that it is the "small family farm" that is the primary beneficiary. From the time oil was discovered in the U.S. in the 1860s, various government agencies have been warning of an impending depletion of the oil supply unless there is a governmental takeover. Government-funded lies about environmental policy are almost too numerous to count. Military policy lies are so pervasive that "Pentagon propaganda" has become a redundancy.

Governmental control of schooling has always been motivated by a desire on the part of politicians to brainwash children in one ideology or another.[14] John Lott has argued that this is so because such brainwashing makes government's income-transfer schemes more palatable to the public, which in turn makes it easier for politicians to maintain power by buying votes with taxpayers' money. In other words, it reduces the transactions costs of wealth transfers.

Although there are countervailing forces, such as certain educational institutions, the internet, talk radio, etc., it is nevertheless true that government still has the ability to drown out most other voices with its vast propaganda resources. And it doesn't need to drown all other voices out; only enough of them so that a majority of the rationally ignorant voting public continues to believe its lies.

These countervailing forces of public opinion have the deck stacked against them in a most lopsided way. When it created the welfare state, the federal government chose to administer its new programs through thousands of ostensibly private, nonprofit organizations. The same is true of many other government programs regarding environmental policy, civil rights policy, old-age policy, labor policy, etc. These nonprofit organizations (including labor unions) receive billions of dollars annually in government grants. Much of this money goes not to assist the poor or the elderly, to improve the environment, etc., but

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[14]Thomas Sowell, *Inside American Education* (New York: Free Press, 1993); and E.G. West, *Education and the State: A Study in Political Economy*, 3rd. ed. (Indianapolis, Ind.: Liberty Fund, 1994).

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to finance the lobbying for bigger budgets for the governmental agencies that made the grants in the first place.[15]

Here's how it works:

1) Government agencies grant taxpayer dollars to nonprofit groups to ostensibly administer government programs.
2) The groups devote half or more of the money (illegally) to a lobbying and publicity campaign in favor of greater taxpayer funding for the program.
3) Congress is "persuaded" to spend more on the program.
4) This allows the nonprofit groups to receive even bigger grants.
5) The whole cycle starts over again from step 1.

The "will of the majority" is much more of a government-manufactured will than even Joseph Schumpeter imagined. Stigler's basic assumption that governments faithfully respond to the wishes of "society" rests on a very weak foundation indeed.

In addition, nearly every state-funded university in America is a *de facto* "think tank" for the promotion of statism. It should surprise no one that as government funding has so overwhelmingly dominated the financing of higher education, most academics who have anything to say about public policy have become paid mouthpieces of the state. Their claims of academic freedom ring hollow.

Stigler's theory of efficient government is based on a model of perfectly competitive government, but in reality the government has long established a system of barriers to entry into politics that renders national politics monopolistic. This, too, is a fatal flaw in Stigler's model. It has not been at all unusual over the past 50 years for well over 90 percent of all congressional incumbents to be reelected in each election cycle because of the formidable incumbent-protection rules and institutions that have been put into place. Incumbent members of Congress receive over $100 million annually in "free" mailing privileges which they use to send campaign literature to their home districts and states. Challengers must pay their own way.

Each congressional representative has more than two dozen taxpayer-financed "staffers," while senators have about 75 staffers each. These individuals effectively comprise a permanent, taxpayer-funded

[15]James T. Bennett and Thomas J. DiLorenzo, *Destroying Democracy: How Government Funds Partisan Politics* (Washington, D.C.: Cato Institute, 1985).

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campaign staff. Challengers must raise money privately to hire their campaign staffs.

Incumbents in Congress have created dozens of committees and subcommittees, the purpose of each is to make sure that each incumbent can be on a committee that specializes in dispensing taxpayer dollars or special favors to the voters of his or her district or state. Farm-state legislators will be on various agricultural committees, for example, whereas those from urban areas will sit on the Banking and Urban Affairs committee. Since it is illegal for challengers to buy votes, this too creates a formidable barrier to entry into politics. Incumbents are free to use taxpayer dollars to buy votes, but challengers can only make vague promises to do so.

In Stigler's perfectly competitive government, any policy that is opposed by enough people will be replaced though the electoral process, just as consumers will replace an inferior product by "voting" with their dollars. But that's only (remotely) possible if there is a reasonable degree of competition in government. In the U.S. federal government, there is not. Even at the state and local levels of government in the U.S., consolidation of local governments and state and federal mandates that tend to homogenize local government policies render state and local government more monopolistic.

Stigler was always a strong proponent of antitrust regulation for the private sector for economic efficiency reasons. Yet, he maintained that monopoly *government* was somehow economically efficient.

FINANCIAL SUBTERFUGE

Another fundamentally fraudulent aspect of democratic governments is their proclivity to hide or disguise the true costs of their operation through various subterfuges, such as off-budget spending, while simultaneously spending billions on propaganda campaigns that wildly exaggerate the supposed benefits of government programs and activities. For well over a century, federal, state, and local governments in the U.S. have responded to citizen demands for tax cuts, expenditure restraints, or debt limitations by paying lip service to these demands while at the same time creating myriad off-budget enterprises that can spend money without the direct approval (via referendum, for example) or even knowledge of the voters.[16] At government's state and local

[16]James T. Bennett and Thomas J. DiLorenzo, *Underground Government: The Off-Budget Public Sector* (Washington, D.C.: Cato Institute, 1983).

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levels, time and time again, when voters reject a spending referenda, politicians routinely respond by establishing off-budget enterprises funded by non-voter approved "revenue bonds." At the federal level, debt finance permits the government to disguise its true cost, as does the "fiscal illusion" created by dozens of well-hidden excise taxes. There is even a "Federal Financing Bank" that was set up in 1974 specifically to place certain kinds of (politically unpopular) spending off the books and to keep it well hidden from the taxpayers.[17]

The essential question that is raised by all these subterfuges is this: If these government programs are genuinely in the "public interest" and efficiency enhancing, why then do politicians consistently go to such great lengths to keep the public from learning about them?

GOVERNMENT AS EXTORTION ARTIST

Another characteristic of democratic governments that calls into question the validity of Stigler's government-is-always-efficient claim is Fred McChesney's well-researched thesis that much of modern democratic government is essentially a protection racket.[18] McChesney models and catalogues dozens of examples of politicians threatening (with proposed laws and regulations) to confiscate the wealth of various individuals or groups unless they (the politicians) receive payoffs and bribes in the form of campaign contributions and other payments. "Payments to politicians are often made," writes McChesney, "not for particular favors, but to avoid . . . political disfavor, that is, as a part of a system of political extortion."[19] Congressmen and congressional staffers refer to such legislation as "juice bills," designed to "squeeze" money from potential contributors, or "milker bills," designed to "milk" money from corporations that would be harmed by, say, a price control law affecting their industry. The threat of price controls or an excise tax imposed on an industry can result in millions of dollars in campaign contributions from the threatened industries.

Even Stigler's vaunted sugar price support program would fall under McChesney's "extortion" designation. The sugar program, like so many government subsidy programs, must be renewed every couple

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[17]Bennet and DiLorenzo, *Underground Government.*

[18]Fred McChesney, *Money for Nothing* (Cambridge, Mass.: Harvard University Press, 1997).

[19]McChesney, *Money for Nothing*, p. 2.

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of years. That way, every couple of years, members of Congress are guaranteed of a new round of bribery as both the sugar farmers and the opponents of the program lobby and make campaign contributions to hopefully shape the "new" bill in their favor. Every five years, this same game is played with a new "farm bill" that goes before Congress. This encourages the maximum amount of rent seeking, and thus the maximum amount of economic inefficiency. Consequently, the longer-lived a special-interest transfer program is, the more economic destruction it will have caused in terms of wasteful rent seeking. Stigler and Wittman have it all backward.

The Myth of Politics as "Just Another Market"

Stigler and Wittman's the-government-is-always-efficient theories assume that there are no significant differences between private property markets and "political markets." "Markets are markets," they would say. Wittman even says that political "markets" are "sufficiently like" private property markets that whatever conclusions hold for private property markets must also hold for politics as well. This is the key assumption of his analysis, and of Stigler's as well, but it is based mostly on faith.

One implication of this assumption is that government pursues its goals every bit as efficiently as does any private business. This is most certainly false because of the stark differences between profit management in private property markets and bureaucratic management in government. As Mises pointed out, because there is no cash value on the market of any governmental agency (they cannot be bought and sold), and there are no profit-and-loss statements in an accounting sense, there is simply no way to know how "efficient" a government enterprise is in pursuing its objectives. Economic calculation is impossible.[20]

In private property markets, entrepreneurs tend to allocate capital in ways that satisfy the most urgent wants of consumers. Resources are allocated and reallocated to their highest-valued uses. No such thing occurs in government, since resources are allocated largely according to the degree of political clout of various special-interest groups, not according to private capital markets. Government budgets only provide information on the amounts of tax dollars spent on particular programs

[20]Ludwig von Mises, *Human Action: A Treatise on Economics*, scholar's ed. (Auburn, Ala.: Ludwig von Mises Institute, 1998), p. 305.

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but say nothing (nor can they) about the opportunity costs of those expenditures, i.e., the subjective value of alternative uses of those tax dollars either by taxpayers or by other government agencies.

In profit-seeking businesses, the managers' behavior is guided by considerations of profit and loss; in government, managers' behavior is guided by arcane, voluminous, and often arbitrary bureaucratic rules.[21] It has to be this way if elected officials are to have any control at all over the bureaucracies to which they allocate taxpayers' revenues. In other words, it is impossible to think of government bureaucracies as being "efficient" in the allocation of resources in the same sense as private competitive businesses are, not to mention the widely-discussed incentives for inefficiency that are know to exist in all government bureaucracies. Indeed, there is wide agreement in the public choice literature and elsewhere that government bureaucracies are best viewed as cost or budget *maximizers* rather than as cost minimizers, as is the case with private competitive firms.

Political Entrepreneurship versus Private Property Entrepreneurship

Private property entrepreneurs succeed by discovering ways to reduce costs and prices, improve product or service quality, or by inventing new products that meet the approval of consumers. They succeed, in other words, by catering to consumers. If they fail to please consumers, they lose money or go bankrupt.

In politics, the opposite is often true: "entrepreneurial" politicians "succeed" by *avoiding* the minor constraints imposed on their behavior by the elections that are held every two or four years. The most "successful" political "entrepreneurs" are the ones who are most adept at convincing a gullible, public-school-educated, rationally ignorant public that they can offer them something for nothing. They are the slickest liars and propagandists. Bill Clinton was arguably the biggest and best liar in American politics over the past half century, and was one of the most successful politicians as well. As discussed above, successful political "entrepreneurs" are good at

- telling official lies about government policy,
- hiding the costs of government with fiscal illusions created by excise taxation and debt finance,

[21]Mises, *Human Action*, p. 306. See also Anthony Downs, *Inside Bureaucracy* (Boston: Little, Brown, 1966).

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- creating off-budget government enterprises to further hide the true costs of government from the public,
- and allocating large amounts of taxpayer dollars to nonprofit-sector special interest groups which grossly exaggerate the benefits and understate the costs of special-interest legislation.[22]

DOLLARS VERSUS VOTES

In private property markets, consumers "vote" with their dollars, to make a Stigleresque analogy. This means that consumers can decide for themselves just how much of any product or service they want, if they want it at all. And they are perfectly free to change their minds more or less constantly by engaging in market transactions. Moreover, all market exchanges are voluntary; no one is forced into them. Market exchange is always *mutually beneficial* as long as it is voluntary.

In dramatic contrast, political "exchange," takes place very seldom. During any eight-year period, each voter is allowed to vote twice for president, four times for a U.S. representative, and, at most, three times for a U.S. Senator, even though those individuals are among the 535 men and women who allocate more than a third of GDP and enforce literally tens of thousands of regulations that affect nearly all aspects of our lives.[23] Moreover, since citizens have no capability to understand anything but a minuscule percentage of what government does, the act of voting is more analogous to judging a beauty contest or attending a sporting event than to a market transaction.[24]

Voting is an all-or-none choice. No disaggregation of issues is permitted, in the sense that the free market allows consumers to "disaggregate" products (I like Coke, you like Pepsi). Once majority rule has

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[22]There is an occasional reformer who genuinely does succeed at making government somewhat more efficient, such as former mayor Brett Schundler of Jersey City, New Jersey, but they seldom last very long in politics, as is the case with Mr. Schundler, who was trounced in New Jersey's November 2001 gubernatorial election.

[23]Don Boudreaux makes this point in "Was Your High-School Civics Teacher Right After All? Donald Wittman's *The Myth of Democratic Failure*," *The Independent Review* 1 (Spring 1996), p. 117.

[24]Goeffrey Brennan and Loren Lomasky, *Democracy and Decision* (New York: Cambridge University Press, 1993).

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decided the winner, that candidate's administration will prevail, creating "political externalities" to all voters both to the left and to the right of that winning candidate. For example, if we used democracy to determine what kind of shoes to produce, and the majority wanted to produce men's shoes in size 10D, then we would become a nation of sore feet, as everyone with bigger or smaller feet would be inconvenienced and would have to rely on black market shoes. This is analogous to market exchange?

THE IMPORTANCE OF PRIVATE PROPERTY

On an even more fundamental level, markets rely crucially on private property and the enforcement of contracts. Without private property, there can be no markets; without markets there can be no economically meaningful prices; and without market prices rational economic calculation—and a functioning economy—is impossible. Property rights provide individuals with incentives to work and produce, and to improve one's ability to do so through training and education, for stable property rights allow one to reap the fruits of such labors.

In contrast, for the most part, democratic government involves a process of one group of citizens bribing legislators to *attenuate* the private property rights of others for no other reason than the first group wishes to (legally) steal the others' property.[25] It is the domain of rent-seeking behavior. The business of modern democracy is to attenuate property rights in order to fuel the special-interest, rent-seeking machine. This is very much the *opposite* of voluntary, consensual, private property markets. Merely repeating over and over that "politics is like markets," as Stigler, Wittman, and some other Chicago School scholars have done, does not make it so. The attenuation of property rights that is the defining characteristic of democracy weakens incentives to be productive while increasing the rewards of unproductive rent seeking.

One implication of this analysis is that the people who rise to the top in democratic governments are those who are adept at orchestrating

[25]A study prepared for the Joint Economic Committee of Congress in 1998 concluded that only 14 percent of all federal expenditures could conceivably be construed as "economically productive" expenditures that facilitated economic growth, as opposed to pure transfer payments. See Joint Economic Committee, *The Size and Functions of Government and Economic Growth*, report prepared by James Gwartney, Robert Lawson, and Randall Holcombe, 1998.

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the rent-seeking game. Indeed, years of experience at lower levels of office (city council, state legislature) is the usual prerequisite for higher office. As Hans-Hermann Hoppe puts it, "democracy virtually assures that only dangerous men will rise to the top of government."[26] Dangerous, in the sense that they are adept at destroying property by facilitating the plunder of rent seeking. As rent seeking becomes more pervasive in a democracy, more and more people will decide to try to become adept at it rather than becoming genuinely productive citizens. The proportion of parasites will rise relative to producers, which will cause national wealth to be lower than it would otherwise be. Hoppe has written:

> [A]ny income or wealth redistribution within civil society implies that the recipients are made economically better off without having produced either more or better goods or services, while others are made worse off without their having produced quantitatively or qualitatively less. Not producing, not producing anything worthwhile, or not correctly predicting the future and the future exchange-demand for one's products thus becomes relatively more attractive . . . as compared to producing something of value and predicting the future exchange-demand correctly. Consequently . . . there will be more people producing less and displaying poor foresight, and fewer people producing more and predicting well.[27]

This is not a very "efficient" prospect.

Private property markets induce many people to moderate their time preference rate and be somewhat future oriented. Homeowners, for example, have incentives to preserve the value of their property because any appreciation accrues solely to them upon sale, as do any losses. Democratic government, on the other hand, promotes an increase in the rate of time preference (short-term thinking)—what Hoppe calls the "infantilization of society"—with its constantly expanding taxation and spending, inflation, and unending flood of special-interest legislation designed to satisfy every perceived want of every segment of the electorate.[28] This is another important source of inefficiency to which Stigler and Wittman pay no attention.

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[26]Hans-Hermann Hoppe, "The Democratic Leviathan," *www.mises.org*. See also his book *Democracy—The God that Failed* (New Brunswick, N.J.: Transaction Publishers, 2001).

[27]Hoppe, *Democracy—The God that Failed*, p. 32.

[28]Hoppe, *Democracy—The God that Failed*, p. 32.

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DEMOCRACY AS BANDITRY

Modern democracies have evolved into gangs of bandits who rely on the public's worshipful attitude toward democracy (promoted for generations in the government-run schools) to "justify" the game of stealing one person's property in order to buy votes from two or more others with it. But America's founding fathers did not believe in democracy and they did not establish one, and for good reason: they understood that democracy would quickly become the kind of system that we have today. In hindsight, they were naive to believe that the Constitution would be sufficient to block this outcome.

One political theorist who understood this was John C. Calhoun, former American vice president, secretary of war, senator, and congressman. Calhoun understood that under any kind of democracy, the community will inevitably be divided into:

> two great parties, a major and a minor, between which there will be incessant struggles on the one side to retain, and on the other to obtain the majority—and thereby, the control of the government and the advantages it confers.[29]

There would be "two great hostile parties," comprised of "the payers of the taxes and the recipients of their proceeds," with the inevitable result that society will be divided into:

> two great classes; one consisting of those who, in reality, pay the taxes, and, of course, bear exclusively the burden of supporting the government; and the other, of those who are the recipients of their proceeds (the tax-consumers).[30]

Because of the powerful incentives that the tax-consuming class would have to plunder the taxpaying class, Calhoun did not believe that the Constitution was sufficient to keep the government from becoming a permanent instrument of plunder. The tax-consuming majority would perpetually "endeavor to elude" all constitutional restrictions on their plundering ways, and they would wage a relentless propaganda campaign to portray such restrictions as "folly."[31] Calhoun supported the rights of secession and nullification, as did nearly all of the founding generation, and introduced the concept of a concurrent majority—

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[29]John C. Calhoun, *Union and Liberty: The Political Philosophy of John C. Calhoun*, ed. R.M. Lence (Indianapolis, Ind.: Liberty Fund, 1992), p. 16.

[30]Calhoun, *Union and Liberty*, p. 19.

[31]Calhoun, *Union and Liberty*, p. 27.

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the right of a subgroup of the population, such as a state, to veto unconstitutional legislation. All of these protections against the plunder of democracy were abolished in 1865 when the federal government finally established its supremacy over the states and the citizens, and appointed itself as the final arbiter of constitutionality.[32]

The kind of constitutional republic that existed in the U.S. prior to 1865 had very few income transfer programs. The only contact the average citizen had with the federal government was through mailing a letter. There were no long-lived income transfer programs, and the economy was much more efficient as a result. Yet, it is the post-war democracy, not the constitutional republic of the founding fathers, that Stigler and Wittman theorize as efficient, which again seems altogether backwards. There are many varieties of democracy, but Stigler and Wittman treat all of them equally. In doing so, they ignore centuries of political philosophy, including modern public choice theory, that has much to say about how all the various permutations of democracy have led to very different results over time and space. Economists can arrive at some awfully absurd conclusions if they insist on ignoring the study of history and philosophy while commenting on such momentous issues as the successes and failures of democracy.

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[32]For more on Calhoun's thought, see the symposium on "Federalism, War, and Reconstruction: Antecedents and Consequences of the War Between the States," *Journal of Libertarian Studies* 16, no. 2 (Spring 2002). In particular, see K.R. Constantine Gutzman, "Paul to Jeremiah: Calhoun's Abandonment of Nationalism," and H. Lee Cheeck, Jr., "Calhoun, Sectional Conflict, and Modern America."

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UNDERMINING PROPERTY RIGHTS: COASE AND BECKER

Gary North*

"Coase, get your cattle off my land."
–Walter Block

In one sentence, Walter Block called into question Ron Coase's central conclusion in his now-famous theorem, namely, that the original distribution of ownership would not affect the allocation of scarce resources in a free market, if there were no transaction costs.

COASE AND HIS THEOREM

In 1937, a young Ron Coase published an important study of the firm,[1] but for the next two decades, he published very little in professional scholarly journals.[2] Then, in 1960, like a bombshell, came his most famous work, "The Problem of Social Cost."[3] In it, he laid out what has since become known as the Coase theorem.

The theorem reaches its central conclusion by implicitly denying the economic efficiency of the judicial doctrine of strict liability. In order to deal with the real world, in which there is no such thing as a costless transaction, Coase proposed a solution: in judicial cases where

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[1]Ronald H. Coase, "The Nature of the Firm," *Economica* 4 (1937), pp. 386–405.

[2]A bibliography of Coase's works appears in "On the Resignation of Ronald H. Coase," *Journal of Law and Economics* 26 (April 1983). See also The Ronald Coase Institute, *www.Coase.org*. The bulk of his academic articles came after 1960.

[3]Ronald H. Coase, "The Problem of Social Cost," *Journal of Law and Economics* 3 (1960), pp. 1–44.

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an owner challenges the invasion of his property by a non-owner, the judge should allocate access in terms of the highest efficiency use of the property, i.e., its highest social utility. This principle of law sacrifices the rights of private owners to a hypothetical public good in which rent-seeking invaders act in the name of the general public, and the courts have the legitimate authority to ratify their claims.

Coase's prose style allowed non-economists to read and understand. Lawyers especially grasped its crucial point: if you can persuade a judge or jury that it is in the general public's economic self-interest to allow your client to steal income from another person's property, then scientific economics teaches that you are helping to restore economic efficiency.

His clear presentation and the revolutionary nature of this doctrine has won Coase many important accolades. In 1991, he was awarded the Nobel Prize in Economics, and the Swedish Academy specifically singled out this article.[4] As of 1996, "The Problem of Social Cost" was the most-cited law review article in history, with 1,741 citations. The runner-up had only 359.[5]

Coase first presented his theorem to members of the economics department of the University of Chicago at a private meeting. They initially challenged him on his then-revolutionary thesis, namely, that in the absence of transaction costs—a real-world impossibility, of course—the unhampered free market will distribute income in whatever way equates social utility with social cost, no matter which party possesses title to the income-producing property. With respect to the classic textbook example of welfare economics, Coase argued that in the case of a dispute between a railroad company, whose coal-fired engine emits sparks, and a farmer whose field may be set on fire by these sparks, private negotiations between the field's owner and the railroad company's executives will allocate the railroad's income and farmer's income in the way that maximizes social utility. His argument assumes no transaction costs.

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[4]See *www.nobel.se/economics/laureates/1991/press.html* for the official press release by the Nobel committee. See also Tom Bethell, *The Noblest Triumph: Property and Prosperity through the Ages* (New York: St. Martin's Press, 1998), p. 315.

[5]Fred R. Shapiro, "The Most-Cited Law Review Articles Revisited," *Chicago-Kent Law Review* (1996), p. 751. See also "Chicago Journal," *The University of Chicago Magazine* (February 1997).

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At first, his listeners were unpersuaded, but as the evening wore on, Coase converted them, one by one: Milton Friedman, his brother-in-law Aaron Director (the editor who then decided to publish "The Problem of Social Cost"), and George Stigler.[6] The Chicago economics department soon hired Coase away from the University of Virginia.[7]

Yet, not everyone in the economics profession lauded Coase's revolutionary idea. In 1974, at the famous South Royalton conference for Austrian economics, a young Walter Block called into question Coase's central conclusion when he quipped, "Coase, get your cattle off my land!" In one sentence, speaking in the name of property owners, Block identified the chief problem with Coase's theorem: its implicit rejection of private property rights. Block's statement hit the theorem on methodological, epistemological, and ethical grounds.

In 1977, Block wrote a brief essay refuting Coase's theorem.[8] Like Coase, Block avoided the standard professional economic paraphernalia of graphs and equations, making his argument with words, logic, and examples. Unlike Coase's article, though, Block's article received almost no attention.[9]

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[6]Bethell, *Noblest Triumph*, p. 316.

[7]The University of Virginia thereby became the world record-holder in departed future Nobel Prize winners in economics. Coase and James Buchanan both left Virginia before they won the prize. This shows a degree of negative academic entrepreneurship unmatched by any other economics department.

[8]Walter Block, "Coase and Demsetz on Private Property Rights," *Journal of Libertarian Studies* 1, no. 2 (1977), pp. 111–15.

[9]For another attack on the Coase theorem that has received almost no attention, see Gary North, *The Coase Theorem: A Study in Epistemology* (Tyler, Tex.: Institute for Christian Economics, 1992). A few weeks after Coase won the Nobel Prize, I sent a large box of copies of the book to the economics departments of about a dozen major universities. I asked the secretaries to put one in each faculty member's mailbox; I received only a single letter of thanks from a faculty member. The book was ignored by the profession, and I have never heard a word from Coase himself, who is still alive as I write this.

Neither my book nor Block's article (which my book cites) appears in the text or the 13-page bibliography in the 55-page, 1998 article by Steven Medema and Richard O. Zerbe, Jr., "The Coase Theorem," in *Encyclopedia of Law and Economics, http://encyclo.findlaw.com/0730book.pdf.*

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THE IMPACT OF THE COASE THEOREM

Chicago School economist-judge-legal theorist Richard Posner goes so far as to argue in his widely read textbook on law and economics that Coase's article and one by Guido Calabresi[10] were instrumental in launching an entire academic discipline, law and economics, "the application of the theories and empirical methods of economics to the legal system across the boards."[11] The Coase theorem "established a framework for analyzing the assignment of property rights and liability in economic terms." As he wrote in 1981, "Until recently, then, utilitarianism held sway in legal theory, but overt economic analysis was rare. The position is now reversed."[12]

Coase's essay was perhaps the key one in the revival of academic economists' interest in the question of pollution and economic theory, as well as a crucially important contribution to a free market theory of property rights. It is by far the most important modern article on welfare economics.

Coase, Pigou, and Robbins

Coase summarized the state of the welfare economics debate—it had long ceased to be debated very much—as of 1960. Cambridge University economist Arthur Pigou had formulated the debate over welfare economics in the early decades of the twentieth century, defending the graduated income tax on the basis of marginal utility theory. Pigou argued that the marginal value of the next unit of income is lower for a rich man than for a poor man, so social utility increases when the state coercively transfers income from the rich to the poor. His argument implicitly assumed that the subjective utilities of two people, and, indeed, whole classes, can be measured by a third person: the person who writes the tax code. Without the possibility of measuring interpersonal comparisons of subjective utility, there can be no scientifically valid welfare economics.

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[10]Guido Calabresi, "Some Thoughts on Risk Distribution and the Law of Torts," *Yale Law Journal* 70 (1961), pp. 499ff.

[11]Richard A. Posner, *Economic Analysis of Law* (Boston: Little, Brown, 1986), p. 19.

[12]Richard A. Posner, *The Economics of Justice* (Cambridge, Mass.: Harvard University Press, 1983), p. 54.

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In a related discussion of welfare economics, Pigou established what was to become the traditional framework for pollution economics, a subset of welfare economics. This discussion was categorized under the general rubric of "externalities": the imposition of a firm's costs of operation on those who are not owners of the stream of future income generated by the production process. In other words, these victims are *external* to the firm or production unit, but not external to its costs of operation. Almost without exception, the economists' discussion of externalities ended with a consideration of possible state measures that can reduce or eliminate these externalities. The conclusions reached by most economists, based on Pigou's analysis in *The Economics of Welfare*,[13] were as follows, Coase summarized: the producer of pollution (smoke, noise, etc.) should 1) pay damages to those injured, or 2) have a tax imposed on his production by the civil government, or 3) have his factory excluded from residential districts.[14] Coase's article broke with this tradition.

Here we come to one of the great ironies in the history of modern economic thought. Pigou, a dedicated socialist,[15] came out in favor of defending the farmer's property against the invading railroad which placed the farmer's crops at risk. Coase, now the scion of the Chicago School, established his reputation by formally denying that the farmer is entitled to any such automatic legal protection. On the contrary, he argued, a civil court has the obligation to allocate damages between the farmer and the railroad in its quest to maximize the public's social value. Each party damages the other, and the courts must allocate this damage. In Coase's legal world, the farmer's refusal to allow the railroad company to set fire to his crops is seen as imposing economic damage on the railroad company—damage which may be greater, in terms of reduced social utility, than the damage imposed on the farmer by the engine that spews out sparks.

Coase's theorem undermines an ancient tradition of Western jurisprudence that goes back to the Mosaic law:

> If a man shall cause a field or vineyard to be eaten, and shall put in his beast, and shall feed in another man's field; of the best of his own field, and of the best of his own vineyard,

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[13]A.C. Pigou, *The Economics of Welfare*, 4th ed. (London: Macmillan, 1932).

[14]Coase, "The Problem of Social Cost," pp. 1–2.

[15]A.C. Pigou, *Socialism vs. Capitalism* (London: Macmillan, 1937).

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> shall he make restitution. If fire break out, and catch in thorns, so that the stacks of corn, or the standing corn, or the field, be consumed therewith; he that kindled the fire shall surely make restitution.[16]

The strict liability implied by this judicial principle of restitution for damages is foreign to the Coase theorem and the school of economic opinion that has successfully promoted it.

Aaron Levine summarizes Coase's theoretical breakthrough:

> Assuming zero transaction costs and economic rationality, Coase, in his seminal work, demonstrated that the market mechanism is capable of eliminating negative externalities without the necessity of governmentally imposed liability rules.[17]

Furthermore, the theorem leads to the conclusion that "if transactions are costless, the initial assignment of a property right will not determine the ultimate use of the property."[18] I might add that if pigs had properly designed wings, they could fly.

The problem here is simple: there are and always will be transaction costs.[19] Or, I should say, this is one problem with the Coase theorem. The major problem is never confronted by Coase or his many defenders, namely, that his theorem imputes zero economic value—and therefore zero relevance—to the owner's sense of moral and legal right associated with a willful violation of his property. It also ignores the economic relevance of third parties' sense of moral outrage and helplessness when there is no predictable enforcement by the civil government of owners' legal immunities from invasion, even if done in the name of a "more efficient" social good or social goal.

This is why the Coase theorem is one of the most morally insidious pieces of academic nonsense ever to hit the economics profession. Worse, it has infected the thinking of a generation of very bright and very glib free-market economists and legal theorists, and has drastically

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[16]Exodus 22:5–6.

[17]Aaron Levin, *Free Enterprise and Jewish Law: Aspects of Jewish Business Ethics* (New York: Yeshiva University Press, 1980), p. 59.

[18]Posner, *Economic Analysis of Law*, p. 7.

[19]For a brief introduction to the question of transaction costs, see Oliver E. Williamson, "Transaction-Cost Economics: The Governance of Contractual Relations," *Journal of Law and Economics* 22 (October 1979), pp. 233–61.

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compromised the academic case for liberty. It has imposed private costs on those of us who are attempting to make a case for free market economics. In this sense, Coase's theorem is a form of pollution. But, because it is intellectual pollution, those injured cannot take him to court and sue for damages. The best we can do is offer a pollution-control system: proof that his whole argument is specious.

From the beginning, Coase fully recognized the nature of the technical economic problem he had raised, namely, the impossibility of a world in which there are no transaction costs. (The moral issues related to property rights, he dismissed without a moment's public hesitation as irrelevant to economic analysis.) Therefore, he allows civil judges to intervene to settle disputes over lawful access to the fruits of property.

But there is a problem here: Coase cannot escape that nagging problem ignored by Pigou and all welfare economists, namely, the problem of interpersonal comparisons of subjective utility. Ever since 1932, when Lionel Robbins demonstrated the impossibility of making scientifically valid comparisons of interpersonal subjective utility,[20] the economics profession has been involved in a game of "let's pretend we can—or the judges can." Coase's case against Pigou rests on the implicit assertion that specialists, especially judges, can make such comparisons. He implicitly assumes that, somehow, social costs and social benefits can be equalized by judges, but only at the expense of ignoring the twin doctrines of strict liability and private ownership, i.e., the right to exclude. He never explains how judges can do this, nor does he deal with Robbins's classic refutation of Pigou's assumption regarding progressive taxation: the possibility of making scientifically valid interpersonal comparisons of subjective utility. Coase shares this assumption with Pigou.

Reciprocal Harm

Coase reformulated the terms of the debate over externalities.

> The question is commonly thought of as one in which A inflicts harm on B and what has been decided is: how should we restrain A? But this is wrong. We are dealing with a problem of a reciprocal nature. To avoid the harm to B would

[20]Lionel Robbins, *The Nature and Significance of Economic Science*, 2nd ed. (London: Macmillan, 1935), pp. 138–41.

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> inflict harm on A. The real question that has to be decided is: should A be allowed to harm B or should B be allowed to harm A? The problem is to avoid the more serious harm.[21]

To begin with, such reasoning is morally perverse, if it is accepted as a methodological standard governing economic analysis in all instances involving competing economic actions. It would be just as easy to say of kidnapping that any restrictions on kidnapping by the state harm the kidnapper, and that a lack of restrictions harms the victims. If we are going to build an economic system in terms of the supposedly "reciprocal nature of harm"—that each economic actor suffers harm when he is restricted from acting according to his immediate whim—then economics becomes positively wicked, not value-free, in its attempt to sort out just how much harm the courts will allow each party to impose on the other.

Coase offered the following example of reciprocal harm concerning cattle that stray onto another man's property and destroy crops:

> If it is inevitable that some cattle will stray, an increase in the supply of meat can only be obtained at the expense of a decrease in the supply of crops. The nature of the choice is clear: meat or crops?[22]

This appears to be correct economic analysis, as far as it goes. It forces us to think about the problem in terms of what members of the society must give up, meat or crops. But his next sentence is the very heart of the problem, and he never shows how economists—or anyone else, for that matter—can, as scientists, make an economically rational (i.e., neutral) choice in the name of society: crops vs. meat. "What answer should be given is, of course, not clear until we know the value of what is obtained as well as the value of what is sacrificed to attain it."[23]

So value must be sacrificed. Economists need to ask several questions: Value to whom? Society as a whole? The value to the cattle owner? The value to the farmer? Also, how can we make such estimates of economic value, since economic value is subjective? Questions of economic value are the main problems raised by his paper, yet he cannot answer them by means of the "scientific economics" he

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[21]Coase, "The Problem of Social Cost," p. 2.

[22]Coase, "The Problem of Social Cost," p. 2.

[23]Coase, "The Problem of Social Cost," p. 2.

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proclaims. No economist can. Peter Lewin has gone to the heart of the matter when he writes in a withering critique of Coase that:

> costs are individual and private and cannot be "social." The social-cost concept requires the summation of individual costs, which is impossible if costs are seen in utility terms. The notion of social cost as reflected by market prices (or even more problematically by hypothetical prices in the absence of a market for the item) has validity only in conditions so far removed from reality as to make its use as a general tool of policy analysis highly suspect. . . .
>
> The foregoing suggests that any perception of efficiency at the social level is illusory. And the essential thread in all the objections to the efficiency concept, be it wealth effects, distortions, or technological changes, is the refusal by economists to make interpersonal comparisons of utility. Social cost falls to the ground precisely because individual evaluations of the sacrifice involved in choosing among options cannot be compared.[24]

Since there are no "neutral, scientific" answers, Coase's whole essay is an exercise in intellectual gymnastics, an illusion of scientific precision.[25] Nevertheless, it is considered a classic essay, a pioneering work which literally created a new approach in both economics and legal theory. What is revealing is that the economics profession as a whole has refused to face up to this problem.

PROPERTY RIGHTS

The meaning of "property rights" is this: individuals (or associations represented by individuals) possess a legal right to prevent others from stealing, invading, destroying, or otherwise interfering with their property. Owners therefore possess *a legal right to exclude others* from the use of specified property. The phrase "property rights" means that

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[24]Peter Lewin, "Pollution Externalities: Social Cost and Strict Liability," *Cato Journal* 2 (Spring 1982), pp. 220, 222.

[25]This same illusion of scientific precision is at the heart of virtually every professional journal in economics, every mathematical question, and every call for scientific policy-making issued by members of the economists' guild. The day that an economist admits to himself that no economist can make interpersonal comparisons of subjective utility is the day that his public claims of economics' objective, scientific precision make him a charlatan. The day before, he was simply ignorant.

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there is a legally enforceable "bundle of rights" that is associated with specific forms of property.

Coase's essay undermines the very concept of private property rights. He offers a detailed, carefully constructed argument concerning the marginal gains to the cattleman vs. the marginal losses to the farmer from a roaming steer. What the essay demonstrates, assuming that the psychological costs to the farmer of the cattleman's violation of his property rights are never taken into consideration, is this: excluding transaction costs and information costs,[26] as well as assuming perfect competition (omniscience), the gain or loss to society is the same, whether the cattleman compensates the farmer for the value of the lost crops, should the cattle be left to roam, or the farmer compensates the cattleman for the higher costs of meat production, if the cattle are kept away from the farmer's crops (higher feed costs, costs of fencing, etc.). Again, assuming "conditions of perfect competition," Coase concludes:

> Whether the cattle-raiser pays the farmer to leave the land uncultivated or himself rents the land by paying the landowner an amount slightly greater than the farmer would pay (if the farmer was himself renting the land), the final result would be the same and would maximize the value of production.[27]

Given his initial, unrealistic, hypothetical assumptions about free goods—transaction costs, information costs, and perfect competition—this conclusion initially appears to be correct, assuming two things: (1) farmers have no commitment to a sense of justice concerning their property rights, and (2) members of society do not and will not suffer any additional economic losses after the civil government sets a precedent by refusing to make cattle owners responsible for the damage their animals cause. Both assumptions are implicit in Coase's thesis, and both are highly unlikely.

Coase states clearly what he thinks the economic problem is: "The economic problem in all cases of harmful effects is how to maximise

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[26]". . . when the damaging business has to pay for all damage caused *and* the pricing system works smoothly (strictly this means that the operation of the pricing system is without cost)." Coase, "The Problem of Social Cost," p. 2, emphasis in original.

[27]Coase, "The Problem of Social Cost," p. 6.

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the value of production."[28] Furthermore, he is no fool. Later in the essay, Coase drops his essay's initial assumption of zero transaction costs, perfect competition, and zero information costs. Because, in real life, there are transaction costs to settle disputes, there is therefore a role for civil government in settling costly disputes.[29] "All solutions have costs," including solutions imposed by the civil government.[30] But one underlying presupposition distorts all of Coase's analysis—a presupposition which is all too common (and unstated) in Chicago School economic analysis: the legitimacy of leaving aside issues of right and wrong, of justice, of equity.

> Of course, if market transactions were costless, all that matters (questions of equity apart) is that the rights of the various parties should be well-defined and the results of legal actions easy to forecast.[31]

Problem: How can we discuss "the rights of the various parties" if we leave aside questions of equity—questions of right and wrong? In short, how can we discuss "rights" apart from what is *right?*

There would be a sense of outrage among the victims of the polluting factory if there were no enforceable liability rules. The initial reaction of one of the victims, if he knows that the civil law does not protect his ownership rights automatically, may be to blow up the factory or murder its owner. The multiplication of acts of violence would be assured under such a non-liability legal order. The issue of economic efficiency therefore cannot be separated from the issue of judicial equity. This is what Chicago School economists and legal theorists never show any signs of having understood.

When righteous men are thwarted in their cause by seekers of local "efficiency" who care nothing about the ethics of the solution, there will be serious social consequences. To discuss the efficiency of any given transaction without also discussing the equity of it is to begin to deliver the society into the hands of socialist revolutionaries. Or, to put it in language more familiar to Chicago School economists, penalizing righteousness in the name of economic efficiency is not a zero-cost decision.

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[28]Coase, "The Problem of Social Cost," p. 15.

[29]Coase, "The Problem of Social Cost," pp. 15–19.

[30]Coase, "The Problem of Social Cost," p. 18.

[31]Coase, "The Problem of Social Cost," p. 19.

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THE "RIGHT TO INFLICT DAMAGE"

Coase considers an example taken from Pigou's *Economics of Welfare*. Suppose that it would pay a railroad firm to run a train faster than normal, thereby throwing off more sparks. (The example applies to railroads before the era of diesel engines, but it is still valid as an example.) Suppose also that the sparks set a fire that burns a farmer's crop. Pigou said that the railroad company should reimburse the farmer for the loss of his crops by paying him the crop's market value. This, it should be pointed out, is also what Exodus 22:6 says.

Coase denies Pigou's conclusion. "The conclusion that it is desirable that the railway should be made liable for the damage it causes is wrong."[32] Why? Because the economic gains to the total economy, as revealed by the value of the crops lost vs. the cost of installing spark-arresters on the engine, or the losses to the railroad company if the train was not run at all, might be greater by allowing the train to emit sparks.

The judge should consider the monetary value of the burned crops in relation to the cost of installing a spark-arrester or the monetary losses to the company of running the train more slowly, and then make a decision as to what each party owes the other. In other words, he must consider the value of total production. "This question can be resolved by considering what would happen to the value of total production if it were decided to exempt the railway from liability from fire-damage."[33] Coase argues that it might be better for society in general if the farmer's property rights are ignored, leaving him free to pay the railroad company sufficient money to install the spark-arrester. After all, the value of the crop may be greater than the cost of the spark-arrester.[34]

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[32]Coase, "The Problem of Social Cost," p. 32.

[33]Coase, "The Problem of Social Cost," p. 33.

[34]Clearly, the damage inflicted on the crops planted close to the tracks by numerous farmers could be high. The costs would be high to organize the farmers together in order to contribute money to finance the installation of the spark arrester. Each farmer would tend to wait for the others to put up the money. Each would become a "free rider" in the transaction, paying nothing but benefiting from the spark arrester. The payment to the railroad firm probably would not be made apart from intervention by the civil government to compel all farmers who are benefited by the spark arrester to pay their proportional share. The civil government must eventually decide who pays whom: the railroad firm

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What if the farmer had worked for years to build up the soil or build his family's dream home? People are sometimes "irrationally" committed to a piece of real estate: "This land is mine!" A spark-emitting train is now threatening his home's existence, the work of his hands, and his dream or vision. Is he entitled to no legal protection? Isn't the railway *always* liable for damages? Furthermore, if the court decides that the railway is liable—and Coase denies that the court should automatically decide that it is—is the man's shattered dream worth only monetary compensation for the market value of his crops? Maybe he resents the fact that the railway is reducing to mere dollars his right to safety from fire. Shouldn't the engines be fitted with spark retarders, by law? After all, this is not an accidental, occasional incident; this is a daily threat of fire that is a statistically probable event because of the technology involved in running the trains. In short, what about the psychic costs to the victim? Coase's analysis completely ignores this fundamental issue.[35] Coase denies the concept of a single victim: both parties are victims, in his view, for both suffer damages because of the other's action.

"Coase, Get Your Cattle Off My Land!"

What about the farmer who sees the cattleman move in next door? Or the cattleman who sees the sheepherder move in next door? If the other man's animals come roaming into his garden or pasture, isn't the victim entitled to compensation? What if the "accident" of wandering animals is not really an accident, but a regular way of doing business? Shouldn't the offender be required to put a fence around the wandering beasts? Why should the injured party be required by the court to share the costs of fencing? Are the victim's property rights of undisturbed ownership not to receive predictable compensation? If the victim prefers that his neighbor put up a fence in lieu of compensation, on what basis should the courts decide otherwise? What I am arguing, in short, is that the victimized property owner has the right to announce, "Coase, get your cattle off my land!"

My land: there is greater value to me in my right to enjoy my land undisturbed than Coase's reductionist economic analysis indicates. To

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paying damages to the farmers, or the farmers paying "protection money" to the railroad company.

[35]This is Block's main criticism in "Coase and Demsetz on Private Property Rights."

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count the market price of the crops that the cattle trampled, and then to compare that with the price of the meat that someone will put on his table, is to reduce the value of a man's right of undisturbed ownership to zero. Coase's concept of social cost ignores one of the most valuable assets offered to men by a free market social order: the right of an owner to determine who will and who will not have legal access to his property, and on what terms. To think that monetary compensation for damaged goods at a market price is all that matters to an owner is ridiculous. Rothbard is correct:

> There are many problems with this theory. First, income and wealth are important *to the parties involved*, although they might not be to uninvolved economists. It makes a great deal of difference to both of them who has to pay whom. Second, this thesis works only if we deliberately ignore psychological factors. Costs are not only monetary. The farmer might well have an attachment to the orchard far beyond monetary damage. . . . But then the supposed indifference totally breaks down.[36]

Even more important, there must also be compensation for the general loss of security that is necessarily involved in every willful violation of another man's property rights. To argue, as Coase does, that as far as society is concerned, it is economically irrelevant to the total economic value accruing to society whether the victim (farmer) builds the fence at his expense or the cattleman (violator) does at his expense is to place zero price on the rights of ownership. When free market economists place zero economic value on the rights of private ownership, they have given away the case for the free market. This is precisely what Coase and the many academic "economics of law" specialists have done. They have preferred the illusion of value-free economics to the ideal of private property—our legal right to exclude others from using our property.

Theft as a Factor of Production

Coase explicitly argues that the ability to cause economic injury is a factor of production. Therefore, the State's decision to deny a non-owner the legal right to invade another person's property supposedly imposes a social cost: society's loss of a factor of production. In Coase's

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[36]Murray N. Rothbard, "Law, Property Rights, and Air Pollution," *Cato Journal* 2 (Spring 1982), p. 58.

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view, such a rigid exclusion against the invasion of private property is not costless. We might call this the Don Corleone theory of property rights: the right to make a person an offer he cannot refuse. Coase writes:

> If factors of production are thought of as rights, it becomes easier to understand that the right to do something which has a harmful effect (such as the creation of smoke, noise, smells, etc.) is also a factor of production. Just as we may use a piece of land in such a way as to prevent someone else from crossing it, or parking his car, or building his house upon it, so we may use it in such a way as to deny him a view or quiet or unpolluted air. The cost of exercising a right (of using a factor of production) is always the loss which is suffered elsewhere in consequence of the exercise of that right—the inability to cross land, to park a car, to build a house, to enjoy a view, to have peace and quiet or to breathe clean air.[37]

I offer a rival assessment of social costs and benefits. The legal right of owners to exclude others from invading their property is *the* crucial factor of capitalist production. This is the production factor of personal confidence that I will be able to retain the fruits of my labor, my land, and my capital assets. When the legal system denies this predictable protection to owners, the free market is steadily eroded by invaders.

Coase wants us to "have regard for the total effect" of such uses of our so-called capital, namely, the right to pollute the environment.[38] But "total costs" are precisely what he has deliberately chosen to ignore: the right to determine whether or not another person can invade my privacy, wake me up at 2:00 A.M., set fire to my crops, send his cattle to eat in my fields, or, ultimately, sell tickets to people to peek through my window at 3:00 A.M. The economic value of my right to say "Keep your cattle off my land!"—and my right to receive full restitution for the violation of this right—is ignored by Coase and all those economists who take seriously his economic analysis of social costs. He offers economic analysis of the right to inflict damage, but he ignores any economic analysis of the right to deny the damage-producer his so-called right. More than this, Coase explicitly denies the right of property

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[37]Coase, "The Problem of Social Cost," p. 44.

[38]Coase, "The Problem of Social Cost," p. 44.

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owners to have their property defended by predictable law, for he says that any consideration of the right to demand compensation depends on "circumstances."[39] If the right of collecting compensation is not predictable, then the right of private property loses its status as a right.

By elevating the "right to inflict damage" to the same level as the right to demand compensation for a violation of a property right, Coase has effectively compromised the latter right by making a potential right out of the ability to inflict damage. The application of Coase's argument would destroy property rights by attempting to extend the status of property right to a man's ability to damage his neighbor's property. Nowhere in his article does Coase discuss the economic costs to society of compromising the injured party's right to demand and receive by law either (1) support for his exclusion of the invader, or (2) economic restitution from the invader. Coase does not even seem to understand the implications of his own argument. Most astounding of all, his arguments have been taken seriously by economists who see themselves as defenders of the free-market order.

Becker on Crime and Punishment: Sub-Optimal Analysis

The year after Coase won the Nobel Prize, Gary Becker won it. Becker had made a name for himself by applying Coase's theorem to crime and punishment. We see in his analysis the same sort of "add it up" reasoning in a subdivision of law and economics: crime and punishment. Ever since Becker's pioneering article in 1968,[40] Chicago School economists have been analyzing crime and law enforcement in terms of a model that minimizes social losses from crime. This model treats social costs and optimal social solutions as if such concepts had scientific validity in a world of subjectivist economic analysis. According to Chicago School economist William Landes:

> Optimal policies are defined as those that minimize the social loss from crime. That loss depends upon the net

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[39]Coase, "The Problem of Social Cost," p. 21.

[40]Gary S. Becker, "Crime and Punishment: An Economic Approach," *Journal of Political Economy* 76, no. 2 (March–April 1968), pp. 169–217, reprinted in *Essays in the Economics of Crime and Punishment*, ed. Gary S. Becker and William M. Landes (New York: National Bureau of Economic Research, 1974). Subsequent citations are from the book.

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> damage to victims; the resource costs of discovering, apprehending, and convicting offenders; and the costs of punishment itself. These components of the loss, in turn, depend upon the number of criminal offenders, the probability of apprehending and convicting offenders, the size and form of punishments, the potential legal incomes of offenders, and several other variables. The optimal supply of criminal offenses—in essence, the amount of crime—is then determined by selecting values for the probability of conviction, the penalty, and other variables determined by society that minimize the social loss from crime. Within this framework, theorems are derived that relate the optimal probability of conviction, the optimal punishments, and the optimal supply of criminal offenses to such factors as the size of the damages from various types of crimes, changes in the overall costs of apprehending and convicting offenders, and differences in the relative responsiveness of offenders to conviction probabilities and to penalties.[41]

This all sounds so scientific, but it is spurious if economics does not allow the interpersonal comparison of subjective utilities or the aggregating of interpersonal utilities, which it doesn't. But sophisticated, intellectually rigorous analyses such as these certainly increase the likelihood of academic tenure and personal career advancement—an employment guarantee that some people regard as less than socially optimal.[42]

Becker's Breakthrough

Becker insists that his approach to crime and punishment does not "assume perfect knowledge, lightning-fast calculation, or any of the other caricatures of economic theory."[43] Dr. Becker is self-deceived; this is exactly what is assumed in all discussions of socially optimum decision-making. This so-called caricature is, in fact, the heart, mind, and soul of modern economics as an academic discipline. Without it, there could be no mathematics or equations in economic analysis, and without mathematics, one rarely gets articles printed in the prestigious

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[41]William M. Landes, preface to *Essays in the Economics of Crime and Punishment*, p. xiv. Each of the five authors who contributed the book's six essays was, as the time, a professor at the University of Chicago.

[42]See, e.g., Robert A. Nisbet, "The Permanent Professors: A Modest Proposal," *Public Interest* (Fall 1965).

[43]Becker, "Crime and Punishment," p. 9.

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scholarly economics journals.[44] Certainly, his essay is made nearly unreadable by page after page of equations, as are many of his other essays.

Becker insists that "This essay concentrates almost entirely on determining optimal policies to combat illegal behavior and pays little attention to actual policies."[45] In this regard, the essay is representative of virtually the whole field of law and economics. When it comes to suggesting what should be done about crime, Becker prefers equations and equilibrium assumptions to the concept of personal responsibility. He and his colleagues refuse to honor Charles Baird's warning: "Since all costs and benefits are subjective, no government can accurately identify, much less establish, the optimum quantity of anything."[46]

Judges must fly as blind as Becker: "A wise use of fines requires knowledge of marginal gains and harm and of marginal apprehension and conviction costs; admittedly, such knowledge is not easily attained.[47] *Not easily attained!* In terms of the logic of subjective economics, such knowledge cannot be attained at all. Economists cannot make scientific interpersonal comparisons of subjective utility or disutility. Chicago School economists may shudder at the thought of restructuring civil sanctions to make civil law conform more closely to the biblical principle of strict liability and restitution, but, at least so far, they have nothing to offer in its place except endless self-deception regarding the scientific possibility of discovering socially optimal levels of crime and punishment.[48]

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[44]John Kenneth Galbraith, *Economics Peace and Laughter* (New York: New American Library, 1972), ch. 2.

[45]Becker, "Crime and Punishment," pp. 44–45.

[46]Charles W. Baird, "The Philosophy and Ideology of Pollution Regulation," *Cato Journal* 2 (Spring 1982), p. 303. Admit this, and 90 percent of what gets published in the professional academic journals would have to be rejected by the editors. This explains why a career economist such as Isaac Ehrlich would write a section headed "Optimal Participation in Illegitimate Market Activities: A One-Period Uncertainty Model." See Isaac Ehrlich, "Participation in Illegitimate Activities: An Economic Analysis," in *Essays in the Economics of Crime and Punishment.*

[47]Becker, "Crime and Punishment," p. 28.

[48]Consider the essay by Nobel Prize-winning University of Chicago economist George Stigler, "The Optimum Enforcement of Laws," in *Essays in the Economics of Crime and Punishment*, pp. 55–67.

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That Becker's essay does not even consider the possibility of restitution payments by criminals to their victims, but instead focuses on the social benefits of fines paid to the State, indicates how far from common sense these scientific economists are. What mainly disturbs Becker is that with imprisonment, "some of the payment 'by' offenders would not be received by the rest of society, and a net social loss would result."[49] He is so concerned with questions of "net social loss" that he neglects the crucial question of the net *personal* loss suffered by the victim.[50] The word "restitution" does not appear in the index of *Essays in the Economics of Crime and Punishment*.[51]

Two decades later, Becker was still humming the same old tune: deterrence, not vengeance; fines, not restitution to victims. He still has discovered no objective answer to the problem he raises: making the punishment fit the crime. "Obviously, it is hard to estimate damages for many company crimes and even harder to determine the probability of conviction."[52] Hard? By the standards of subjective value theory, it is impossible. But to admit this, Becker would have to remove his equations. Then what?

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[49]Becker, "Crime and Punishment," pp. 24–25.

[50]He says that criminal law should deal only with crimes in which victims cannot be compensated. "Thus, an action would be 'criminal' precisely because it results in uncompensated 'harm' to others." Becker, "Crime and Punishment," p. 33.

I have some questions. First, if someone can serve a prison term or pay a fine to the State, why can't he compensate the victims instead? Second, why does Becker refuse to discuss the overwhelming majority of crimes in which there are identifiable victims, preferring instead to fill up pages with equations? Is he conveniently defining away the problem of crime and punishment for the vast majority of crimes? Third, why does he feel it necessary to put quotation marks around *criminal* and *harm*? Is it because such languages smacks too much of objective moral norms?

[51]The book has approximately 170 pages of equations or parts of equations in its 273 pages, with most of the remainder devoted to charts, graphs, statistical regression analysis, brief bibliographies, and the five-and-a-half page index.

For an equally arcane academic treatment, see David J. Pyle, *The Economics of Crime and Law Enforcement* (New York: St. Martin's Press, 1983).

[52]Gary Becker, "Make the Punishment fit the Corporate Crime," *Business Week* (March 13, 1989).

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The Social Benefits of Criminal Behavior

A unique component of the Becker thesis on criminal behavior is that society's concern, in prohibiting criminal behavior, ought to be the reduction of net social cost. This is a very important qualification. Paul Rubin has seen where Becker is going with this:

> Becker essentially argued that criminals are about like anyone else—that is, they rationally maximize their own self-interest (utility) subject to the constraints (prices, incomes) that they face in the marketplace and elsewhere. Thus the decision to become a criminal is in principle no different from the decision to become a bricklayer or a carpenter, or, indeed, an economist. The individual considers the net costs and benefits of each alternative and makes his decision on this basis. If we then want to explain changes in criminal behavior over time or space, we examine changes in these constraints.[53]

In calculating the net cost to society of any criminal act, Becker insists that we must count as a positive benefit the gains made by the criminal by committing the crime. "The net cost or damage to society is simply the difference between the harm and gain," he writes.[54] How can he say this? Because of his thesis—the one which undergirds this whole subdivision of economics—that criminal behavior is no different from any other profit-seeking behavior. Ethics has no role to play in distinguishing crime from other profit-seeking activities.

> The approach taken here follows the economists' usual analysis of choice and assumes that a person commits an offense if the expected utility to him exceeds the utility he could get by using his time and other resources at other activities. Some persons become "criminals," therefore, not because their basic motivation differs from that of other persons, but because their benefits and costs differ.[55]

First, notice that Becker puts the word *criminals* in quotation marks, indicating his fear of making an ethical judgment in a scholarly journal. Second, he hesitates to follow what economists sometimes call the pure logic of choice.[56] He says that *some* persons become criminals

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[53]Paul H. Rubin, "The Economics of Crime," in *The Economics of Crime*, ed. Ralph Andreano and John J. Siegfried (New York: Wiley, 1980), p. 15.

[54]Becker, "Crime and Punishment," p. 6.

[55]Becker, "Crime and Punishment," p. 9.

[56]On the pure logic of choice, see F.A. Hayek, "Economics and Knowledge," *Economica* 4 (1937).

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"because their benefits and costs differ" from law-abiding persons. Why not use cost-benefit analysis to explain the actions of *all* criminals? Why limit it to only *some*? Why bother to distinguish the non-economic motives of criminals from those of non-criminals? The logic of his argument is that non-economic motives and personal tastes are irrelevant for economic analysis; only costs and benefits are relevant for making predictions regarding people's economic behavior.[57] Why not follow the logic of the argument? Why not conclude in print that there is no theoretically valid economic difference between profit-seeking activities and criminal acts; there are only differences in net social utility? But he does not go this far. It is almost as if some last remaining trace of common sense and moral values has kept Becker from pursuing the logic of his position. One follower has not been so reticent:

> An individual decision to commit a crime (or not to commit a crime) is simply an application of the economist's theory of choice. If the benefits of the illegal action exceed the costs, the crime is committed, and it is not if costs exceed benefits. Offenders are not pictured as "sick" or "irrational," but merely as engaging in activities that yield the most satisfaction, given their available alternatives.[58]

Becker was too timid to pursue his remarkable thesis very far, so let me show you where it leads by considering murder's net social cost or net social benefit. Becker writes that "the cost of murder is measured by the loss of earnings of victims and excludes, among other things, the value placed by society on life itself."[59] But this is insufficiently rigorous by the standards of Chicago School economics. He forgot that the victim's ability to earn a living also involves costs. The producer must eat, use public facilities of various kinds, and be a life-long absorber of resources. So, what Becker really meant to say is that the cost of murder is the net loss—discounted by the prevailing rate of long-term interest, of course[60]—of the late victim's lifetime earning potential, *minus* net lifetime expenditures (also discounted).

This raises a key question: What if the dead victim had been sick, dying, mentally retarded, or in some other way is a net absorber of

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[57]Rubin, "The Economics of Crime," p. 15.

[58]Morgan O. Reynolds, "The Economics of Criminal Activity," in *The Economics of Crime*, p. 34.

[59]Becker, "Crime and Punishment," p. 6.

[60]See Posner's discussion in *Economic Analysis of Law*, pp. 170–81.

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society's scarce economic resources? Must we not conclude that the murderer has in fact increased the net wealth of society? Remember Becker's rule: "society's" estimation of net social costs or benefits "excludes, among other things, the value placed by society on life itself." On what economic grounds could a legislator oppose the concept of selective murder, with criminal indictments to be handed down in specific cases only after a retrospective evaluation (by some committee or other) of net costs and benefits?[61] Who is to say? After all, as he says, "Reasonable men will often differ on the amount of damages or benefits caused by different activities."[62]

If all this begins to sound like the work of a madman, it is only because it is the work of a technically skilled University of Chicago economist who follows the logic of his position.[63] Bear in mind that Becker's essay on crime is regarded by his peers as a classic in the field, comparable to (and written with the same presuppositions as) Coase's essay on social cost. European economist Henri Lapage called Becker's work truly revolutionary, writing that "Gary Becker is classed among the greatest living American economists."[64]

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[61]Becker also fails to mention the value of life to the late victim, which seems a bit odd given the fact that Becker also pioneered a subdivision in the economics profession called Human Capital. See Gary S. Becker, *Human Capital* (New York: National Bureau of Economic Research, 1964). Fortunately, Richard Posner has attempted to rectify this gaping hole in Becker's analysis. He tries to make an objective estimation of the economic value of life to the victim, which he concludes is nearly infinite. He uses a hypothetical example of rising economic payment that someone would demand that would induce him to get involved in death-producing activities: the more likely death becomes, the higher the pay demanded. If death is sure, the price demanded will approach infinity. (Why, then, do men volunteer for suicide missions in wartime?) This is his surrogate for making a subjective posthumous estimation of life's monetary value to the late victim. See Posner, *Economic Analysis of Law*, pp. 182–86. He draws no important conclusions from this analysis, however, and does not include it in his book's index under "death" (for which there is no entry) or under the entries for "murder."

[62]Becker, "Crime and Punishment," p. 45.

[63]For a brief, intelligent, and methodologically rigorous response to Becker, see G. Warren Nutter, "On Economism," *Journal of Law and Economics* 22 (October 1979), pp. 263–68.

[64]Henri Lapage, "The Gary Becker Revolution," in *Tomorrow, Capitalism: The Economics of Economic Freedom* (La Salle, Ill.: Open Court, 1982), p. 161.

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Pin-Stickers and Their Victims

Becker has returned us to the age-old question of the pin-sticker and his victim.[65] If a person enjoys sticking pins into other people, and if other people resent this, what should society do? Should psychologists attempt to construct a measuring device to record the joy of the pin-sticker and then compare it to the pain of his victim? Should judges base their decision of whether to identify this act as a crime in terms of the pin-sticker's pleasure minus his victim's pain—"net social utility"?

Becker wants to consider only people's perceived costs and benefits, risks and rewards, *net*. The logic of Becker's position seems to infer the right of a criminal to inflict damage as heavy as murder so long as he can demonstrate in court through cost-benefit analysis that the particular murder produced net social utility. Coase, writing eight years earlier, was more judicious in his conclusions. He wanted only to assert the right *at some price* of an individual to inflict on other people less permanent forms of damage than murder.

THE SOCIAL COSTS OF THE COASE THEOREM

While there may be an essay by a professional economist that has inflicted more damage on the case for economic freedom than Coase's "Problem of Social Cost," and there may be a scholarly essay that has polluted the moral environment of market choice more than Coase's, I cannot imagine what that essay might be. Becker's 1968 essay, "Crime and Punishment: an Economic Approach," comes close, but it is really only an application of Coase's approach to law.

Coase can argue that his right to inflict such moral damage is merely a factor of academic production. No doubt this essay advanced his academic reputation after 1960. But for every benefit there is a cost: it surely has inflicted and will continue to inflict damage on human freedom, for it assailed the moral case for private property as no article "within the camp" ever had. It created an intellectually and morally bogus concept of the supposed social economic efficiency of production costs that remain the same irrespective of any initial distribution of ownership. With that seemingly scientific and academically irresistible conclusion, Coase seduced some of the brightest economists and

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[65]Gary North, *Dominion Covenant: Genesis*, 2nd ed. (Tyler, Tex.: Institute for Christian Economics 1987), pp. 44–45.

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legal theorists of the next generation. Without a moral case for private property, private property will not survive the attacks, political and intellectual, of its ever-present, ever-envious enemies.

Coase's essay is regarded by many economists, as well as legal theorists, as a classic. It is a classic all right—a classic exercise in rarified and misleading sophistry. Yet, it is taken very seriously by Chicago School economists who have developed the subdiscipline, "the economics of property rights." It was taken seriously by the committee that awarded him the Nobel Prize in economics in 1991. Sometimes even very bright economists can come up with outrageous hypotheses, and the public adopts these "logical discoveries" at its peril. Coase's essay is regarded by academic economists—at least non-Keynesian and non-mathematical economists—as a landmark essay. What it is, on the contrary, is a land mine essay. It blows off both legs of any defender of the free market who inadvertently attempts to stand on it, thereby leaving him, morally speaking, without a leg to stand on. This is a very high personal transaction cost.

Any society that adopts the Coase theorem as its standard of justice must turn over to the courts the right to undermine private ownership. By defining damages as mutual—the fire-setter and his victim—the Coase theorem undermines the very concept of justice by destroying the concept of *victim*. The property owner loses his right to exclude invaders from appropriating some or all of the value of his asset. The Coase theorem turns over to the courts the right to assess damages in the name of the people. When enforced, it encourages property owners to take into their own hands the defense of their right to exclude.

When a man says "Get your cattle off my land" to someone whose cattle really are on his land, a society that seeks peace, including the reduced transaction costs that peace promotes, would be wise to instruct its judges to direct the cattle owner to round up his cattle and take them home. Economists, who generally own neither farms nor cattle, and who rarely are armed, would be wise to assess the potential damages, including high transaction costs, that are fostered by a court system that ignores this fundamental principle of justice.

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DOUGLASS C. NORTH AND NON-MARXIST INSTITUTIONAL DETERMINISM

Joseph R. Stromberg*

Men imprison themselves within structures of their own creation because they are *self-mystified.*
— Edward Palmer Thompson[1]

Douglass North has written many essays and books over forty or more years in which he has sought to reintegrate economic theory and economic history. His project became more and more ambitious over time, producing interesting insights, questions, and narratives. His early interests and work centered on the economics of location, transportation costs, and interregional economic relations in American history. In mid-career, he seized on transaction costs—modified from time to time by other "variables"—as the main motor of history, economic history, and institutional development.

It was North's approach to combining history and theory that helped him bring into being the New Economic History and, later, what North and his school call the New Institutional History. For his efforts, North shared the 1993 Nobel Prize in Economics with Robert W. Fogel, a University of Chicago economist who is a major practitioner of Cliometrics, or quantitative economic history. The Nobel Committee cited North and Fogel "for having renewed research in economic history by applying economic theory and quantitative methods in order to explain economic and institutional change."[2]

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[1]E.P. Thompson, *The Poverty of Theory and Other Essays* (London: Merlin Press, 1978), p. 165.

[2]"Press Release," The Bank of Sweden Prize in Economic Sciences in Memory of Alfred Nobel, *www.nobel.se/economics/laureates/1993/press.html.*

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According to one of North's former graduate students,

> North has attempted to explain the historical transformation of property rights, legal systems, and other institutional arrangements by devising an explicit economic model of institutional change.[3]

In all of his work, North has sought to bring theory into economic history as an explanatory tool. There is, thus, a noteworthy resemblance to Marxism.[4] As with Marxism, practitioners of North's system run the risk of positing universal, directional laws of history.

In the end, though, North's work runs aground because of its reliance on unrealistic models derived from positivist premises and a failure to understand the proper relationship between theory and history.

THE OLD AND THE NEW ECONOMIC HISTORY

Before North and his New Economic History, much of the existing economic history was some variant of historicism. Economic historians offered partial or situational explanations of historical events, sometimes by gathering price series data, but they generally did so in the absence of economic theory (except, perhaps, for some very basic price theory). Such historical analysis was primarily, or even exclusively, empirical. William N. Parker, one the first of the New Economic Historians, describes the older economic history thus:

> The German economic historians who were interested in stages or the English who were interested, like Unwin and Ashley, in pre-capitalist forms were not really concerned with explaining growth. They were concerned with a stage or an historical period as a self-contained mechanism producing a certain class structure, a certain distribution of income and a certain standard of economic welfare and economic power. . . . Economic history was conceived

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[3]Richard Sutch, "Douglass North and the New Economic History," in *Explorations in the New Economic History: Essays in Honor of Douglass C. North*, ed. Roger L. Ransom, Richard Sutch, and Gary M. Walton (New York: Academic Press, 1982), p. 15.

[4]At the University of Washington in the early 1950s, North called himself a Marxist. See *www.nobel.se/economics/laureates/1993/north-autobio.html* for North's autobiographical comments on the subject. See also Jonathan R.T. Hughes, "Douglass North as a Teacher," in *Explorations in the New Economic History*, pp. 4–5 and 9.

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> partly as a means of producing a repertoire of forms of economic organization, primitive, ancient, medieval, early modern, which could be drawn upon by anti-capitalist reformers to ameliorate and counteract the individualistic and exploitative aspects of nineteenth-century capitalism.[5]

In the United States, the older economic historians studied regions, particular industries, labor relations, slavery, or specific problems like the role of salt in the Confederacy, but all without the intrusion of much theory. From the standpoint of the New Economic Historians, this was the great failing of the older ones. The younger scholars also wished to displace competitors such as W.W. Rostow, whose Cold War Liberal presentation of economic history as a theory of *stages* of growth seemed insufficiently theoretical.[6]

Against this background, North and his school emerged. Rather than seeing economic history as something separate from economics, they viewed it as an application, and attempted to analyze history using neoclassical economic theory as a foundation. Neoclassical economics might be defined as "the research program that is founded upon individual rationality with fixed tastes."[7] As one commentator suggested:

> In its purest form, neoclassical economics deals with the allocation of resources under the conditions of perfect information and no transactions costs. Changes are brought on by changes in relative prices; such constraints as tastes, technology, population, and property rights are held constant.[8]

The new economic historians, then, tried to bring neoclassical order into what they viewed as the existing chaos of economic history. They wanted to build models from which testable hypotheses could be drawn.

Rational, maximizing, essentially identical individuals with fixed tastes competing in markets without information costs or transaction

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[5]William N. Parker, "From Old to New to Old in Economic History," *Journal of Economic History* 31, no. 1 (March 1971), pp. 11–12.

[6]W.W. Rostow, *The Stages of Economic Growth: An Anti-Communist Manifesto* (Cambridge: Cambridge University Press, 1960).

[7]Ben J. Heijdra, Anton D. Lowenberg, and Robert J. Mallick, "Marxism, Methodological Individualism, and the New Institutional Economics," *Journal of Institutional and Theoretical Economics* 144 (1988), p. 296.

[8]Andrew Rutten, "But It Will Never Be Science, Either," *Journal of Economic History* 40, no. 1 (March 1980), p. 140.

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costs—the latter being the "economic counterpart of friction"[9]—are the rather unlikely and uninteresting human subjects of neoclassical theory. This circumstance flows from the neoclassical economist's ambition to emulate the proper "scientific" methods of physics.[10] This desire is much in the line of Leon Walras, who stated that "the pure theory of economics . . . resembles the physico-mathematical sciences in every respect." Samuel Bowles and Herbert Gintis observe that, on this ground, "interactions among economic agents might be represented *as if* they were relationships among inputs and outputs."[11]

However, there is "a wide range of problems for which" these neoclassical assumptions are "unworkable, since change in the parameters is the target for explanation."[12] Thus, the question quickly arises whether one can do *history*—even *economic* history—on such a basis? Surveying the early efforts to do so, a veteran of the older economic history, Fritz Redlich, wrote in 1965, that the "new approaches to economic history are definitely positivistic, in that for positivism nothing matters unless it can be counted, measured, or weighed."

However, Redlich argues that the new lines of attack, while "positivistic at their roots, are antiempiricistic through their reliance on economic theory."[13] This circumstance reflects a fundamental problem built into the reigning empiricist and positivist epistemologies which often leads to a discipline split between the advocates of Grand Theory and those of Abstracted Empiricism.[14]

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[9]Oliver E. Williamson, "The Economics of Organization: The Transaction Cost Approach," *American Journal of Sociology* 87, no. 3 (November 1981), p. 552.

[10]John C. Moorehouse, "The Mechanistic Foundations of Economic Analysis," *Reason Papers* 4 (Winter 1978), pp. 49–67.

[11]Samuel Bowles and Herbert Gintis, "The Revenge of Homo Economicus: Contested Exchange and the Revival of Political Economy," *Journal of Economic Perspectives* 7, no. 1 (Winter 1993), p. 84, emphasis in original. Walras is quoted on the same page.

[12] Rutten, "But It Will Never Be Science, Either," p. 140.

[13]Fritz Redlich, "'New' and Traditional Approaches to Economic History and Their Interdependence," *Journal of Economic History* 25, no. 4 (December 1965), p. 481.

[14]C. Wright Mills made a similar observation about the division between sociologists in *The Sociological Imagination* (New York: Oxford University Press, 1970), chaps. 2 and 3.

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Thus, while the addition of economic theory to the study of history was long overdue, it is not at all clear that North's efforts were the correct way to incorporate it. Indeed, the New Economic History may create as many problems as it solves.

THE EVOLUTION OF NORTH'S THINKING

In his successive attempts to infuse theoretical rigor into economic history, Douglass North shifted his interest and focus from topic to topic. Like frontier historian Walter Prescott Webb, who started with the Texas Rangers, moved on to the Great Plains, and finished with the global Great Frontier, North, too, has broadened the scope of his work over time. At each stage, his attempt to reach for greater historical realism has conflicted with the grossly unrealistic assumptions of neoclassical economics, and quite reasonably, therefore, at each stage he has shed or loosened some of those assumptions.

North's Early Work

North's early work was in American economic history, centering on the economics of location and the costs of transportation. He stressed the "export-led" character of American economic development at the local level. Later, North presented a tri-regional model of nineteenth-century American economic development.[15]

North also focused on the use of government by economic interests seeking to channel trade in their direction or to lower artificially their existing transportation costs. His implicit Middle Way political philosophy left a fairly large and legitimate role for government.

Importantly, his arguments suggested that James Madison's political economy, as sketched out in *Federalist* No. 10, was doomed from the outset. Madison famously argued that widening the scope of the union would dilute "factions" (organized economic interests), thereby reducing their influence on public policy. As North's work suggested, a

[15]Claudia Goldin, "Cliometrics and the Nobel," *Journal of Economic Perspectives* 9, no. 2 (Spring 1995), pp. 195–98. For a sample of North's early work, see Douglass C. North, "Location Theory and Regional Economic Growth," *Journal of Political Economy* 63, no. 3 (June 1955), pp. 243–58; Douglass C. North, "Ocean Freight Rates and Economic Development, 1750–1913," *Journal of Economic History* 18, no. 4 (December 1958), pp. 537–55; and Douglass C. North, *The Economic Growth of the United States, 1790–1860* (New York: W.W. Norton, 1966).

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larger union simply set up a scene in which bigger interest groups could compete for control of the *central* government, and in the process wield various broad-constructionist arguments in favor of legislation they wanted.

North and the Cliometricians

Cliometrics, the quantitative study of economic history, was part and parcel of the New Economic History. It came into being, in part, through conferences held at Purdue University in the 1960s.[16] The increased availability of statistical material and price series data helped move it along, as well as the fact that the neoclassical method required numbers with which to work. Advances in computer technology also played a particularly important role. As Thomas Cochran wrote in 1969:

> Greater completeness in mathematical models has been enormously aided by the rapid spread in the use of the computer in the United States. Now the only limit to the number of operative variables is the ingenuity of the scholar in relating them to each other.[17]

For 10 or 15 years, the cliometricians—the statistical wing of the New Economic History—had a brilliant run, seemingly revolutionizing economic history, at least, until satiation or methodological disillusion set in. The most famous product of the school was probably Robert W. Fogel and Stanley L. Engerman's *Time On the Cross*,[18] which revised historical understandings of slavery and the Old South on the basis of statistical models helped along by conjectures, leaps of theoretical faith, and occasional common sense.

However, not everyone found convincing the notion that real historical insight could be gained by running statistical data through hypotheses based on wildly unrealistic assumptions. Fritz Redlich's assessment, already mentioned, was very critical. He distinguished between hypotheses "based on assumptions which are held to have a counterpart in reality" and "figments . . . assumptions having no such counterparts or at least known to be irrealistic." The latter were "mere

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[16]For perhaps the first important salvo from the Cliometricians, see Alfred H. Conrad and John R. Meyer, "The Economics of Slavery in the Ante Bellum South," *Journal of Political Economy* 66, no. 2 (April 1958), pp. 95–130.

[17]Thomas C. Cochran, "Economic History, Old and New," *American Historical Review* 74, no. 5 (June 1969), p. 1568.

[18]Robert W. Fogel and Stanley L. Engerman, *Time On the Cross: The Economics of American Negro Slavery* (Boston: Little, Brown, 1974).

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'as if ' constructs . . . neither verifiable nor falsifiable."[19] He was very critical of the cliometricians as users of figments.

In its earliest phases, North supported Cliometrics, but he became increasingly critical. By the 1970s, a clear separation between North's vision and that of the cliometricians had come into view. Because of this separation, Redlich partly exonerated North from his strictures on Fogel and some others. North's argument in his *Economic Growth of the United States* was "clearly hypothetical as opposed to fictitious," and, thus, fell within the legitimate and necessary methods of the historian. Even so, Redlich went on:

> there is a fictitious element implied in his work, as in that of all scholars who identify economic development with some set of figures, whatever their character. . . . [North's] integrated discussion . . . was made possible by his bringing every phenomenon on a quantitative level . . . [but] figures are not identical with any process whatsoever . . . [since they] stand for something, in this case the *result* of a process.[20]

Douglass North worked in the New Economic History roughly from the late 1950s through the 1960s. He served as co-editor of the *Journal of Economic History* with William Parker from 1960 to 1966. By early 1970s, North was growing restless at the theoretical limitations imposed by neoclassical economic theory. He broke with the statistically-oriented cliometricians and set out on a new path: the New Institutional History, sometimes also called the New Institutional Economics.

To understand North's next evolution, it is necessary to take a momentary digression into the work of Ron Coase.

Ron Coase and the Role of Transaction Costs

Within neoclassical economics, a number of schools now exist,[21] sharing theoretical fundamentals but disagreeing on how best to apply

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[19]Redlich, "'New' and Traditional Approaches," p. 484.

[20]Redlich, "'New' and Traditional Approaches," pp. 485–86, emphasis in the original.

[21]These schools and their key thinkers include Nobel laureate Milton Friedman and Monetarism, Nobel laureate Ron Coase and Law and Economics, Nobel laureate James Buchanan and Public Choice, Nobel laureate Douglass North and the New Economic / New Institutional History, and Nobel laureate Robert Lucas and the Rational Expectations / New Classical school.

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those principles. When North and his colleagues began propagating their new economic history, they did so within the specific neoclassical tendencies that arose around the work of English economist Ronald H. Coase.

In his classic 1937 paper "The Nature of the Firm," Coase put forth the idea that transaction costs are the key to firms, and that firms are created because their transaction costs are lower than are the costs of using the price mechanism for allocating resources.[22] (However, according to Oliver E. Williamson, a proponent of explanations via transaction costs, it was "John R. Commons in 1934" who first maintained "that the transaction is the basic unit of economic analysis."[23])

Analysis centering on transaction costs was taken into the emerging Chicago School tool kit resulting in the rise of the Law and Economics field with its own *Journal of Law and Economics*, founded in 1958. In 1960, Coase added the very influential paper "The Problem of Social Costs," in which he extended his analysis of transaction costs and legal issues.[24] In 1964, Coase migrated to the University of Chicago, where he spent the rest of his academic career.

Although many commentators write as though Law and Economics has involved a raid by economists into the fields of the legal theorists, it was, in fact, the role of Coase and his successors to bring ideas of questionable value to economics from the law, where they already abounded.[25] As we have seen, Commons anticipated Coase's "turn" by a few years, when he observed that:

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[22]Ronald H. Coase, "The Nature of the Firm," *Economica* 4 (November 1937), pp. 386–405.

[23]Williamson, "Economics of Organization," p. 550.

[24]Ronald H. Coase, "The Problem of Social Cost," *Journal of Law and Economics* 3 (October 1960), pp. 1–44.

[25]Judges were never shy about reallocating property titles between parties or even to the state itself in the name of the people. For an array of proto-Coasean decisions and polices, see Morton Horwitz, *The Transformation of American Law, 1780–1860* (Cambridge, Mass.: Harvard University Press, 1977); Harry N. Scheiber, "Property Law, Expropriation, and Resource Allocation by Government: the United States, 1789–1910," *Journal of Economic History* 33, no. 1 (March 1973), pp. 232–51; and Harry N. Scheiber, "Regulation, Property Rights, and Definition of 'The Market': Law and the American Economy," *Journal of Economic History* 41, no. 1 (March 1981), pp. 103–9.

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> the court starts with a transaction. . . . The transaction is two or more wills giving, taking, persuading, coercing, defrauding, commanding, obeying, competing, governing, in a world of scarcity, mechanism and rules of conduct.[26]

But what comes into court is a dispute *about* a transaction. It hardly follows that transactions must therefore become the central theoretical unit of focus for economic theory. As for transaction costs themselves, we may provisionally define them as costs involved in the negotiation and enforcement of contracts.

Richard a Posner, a Coasean and a federal judge, summarizes the Coase Theorem thusly:

> If transaction costs are zero, the initial *assignment* of a property right—for example, whether to the polluter or to the victim of pollution—will not affect the *efficiency* with which resources are allocated.[27]

R.C.O. Matthews adds:

> Coase argued that any system of property rights is capable of leading to Pareto-efficiency provided it is a complete system, a complete system meaning one where all rights to all the benefits from all scarce resources are imputed to someone and are tradeable; but that a complete system is never possible, because of transaction costs; and that some incomplete systems, i.e. some institutions, are more conducive to a Pareto-efficiency than others.[28]

As such, Coaseans dislike "public intervention in markets beyond what is defensible in strict wealth-maximization terms." But the law should intervene when transaction costs are "incorrigibly prohibitive, to bring about the allocation of resources that would exist if they were zero."[29]

Here we are at the intersection of a whole set of issues, or maybe different aspects of the same problem. Coaseans claim that they can intelligently discuss efficiency at the level of whole economies mechanistically modeled on physics. From this, they can draw conclusions

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[26]Quoted in Richard Swedberg, "Major Traditions of Economic Sociology," *Annual Review of Sociology* 17 (1991), p. 256.

[27]Richard A. Posner, "Nobel Laureate: Ronald Coase and Methodology," *Journal of Economic Perspectives* 7, no. 4 (Fall 1993), p. 195, emphasis added.

[28]R.C.O. Matthews, "The Economics of Institutions and the Sources of Growth," *Economic Journal* 96 (December 1986), p. 904.

[29]Posner, "Nobel Laureate," pp. 201 and 203.

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about transaction costs—what they are and who should pay them—in the name of overall "social efficiency." These problems, in turn, are bound up with such matters as "public goods," free-rider problems, and the ideal role (if any) of the state in economic life, as well as with "externalities," that is, "bads" such as pollution or trespasses.[30]

However, the term "trespass" necessarily assumes boundaries grounded on pre-existing property rights, boundaries which these writers wish to hold in suspense while they work out the larger social gains or losses. Thus, the Coaseans are making an elaborate end-run around the generally admitted (and then dismissed) problem of interpersonal comparisons of utility.[31] They stay within their utilitarian, positivist, and empiricist framework, and yet make statements about desirable public (state) policy.

Eirik G. Furubotn and Svetozar Pejovich catch the spirit of the movement when, discussing property rights, they write:

> If the prevailing structure is to be modified by social action designed to reduce or eliminate the effects of an externality, taxes must be imposed on those who will gain from the proposed legal change, and compensation paid to those who will suffer capital loss or loss of satisfaction [!] as a result of the new law.[32]

Thus, in the name of maximum economic growth, economic output, and social welfare, Coaseans call for elimination of "too high" transaction costs by some authority—the state, experts, judges—via reallocation of property "rights" to those who can absorb the shifted costs more cheaply.

Out of this theoretical orientation arose the very influential Law and Economics research program and a whole intellectual movement working within so-called "property rights economics." Yet, as Gary

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[30]The size of enterprises, the choice between enlarging a firm or using external markets, socialist calculation, and anti-trust issues are also implicated in these discussions.

[31]On the problems of interpersonal utility comparison, see Murray N. Rothbard, "Toward a Reconstruction of Utility and Welfare Economics," chap. 10 in *Money, Method, and the Austrian School*, vol. 1 of *The Logic of Action* (Cheltenham, U.K.: Edward Elgar, 1997), pp. 211–54.

[32]Eirik G. Furubotn and Svetozar Pejovich, "Property Rights and Economic Theory: A Survey of Recent Literature," *Journal of Economic History* 10, no. 4 (December 1972), p. 1142. Their survey, pp. 1137–62, stands as a good review of the so-called "property rights economics" literature up to 1972.

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North has written, the whole undertaking was grounded on "R.H. Coase's theorem . . . one of the most subtle yet profound attacks ever written on the concept of private property rights."[33] In short, it could be argued that this "property rights" movement was "about" property rights, or "interested" in them, but not necessarily in favor of them.

North's Institutional Turn

In his next phase, Douglass North began incorporating Coase's ideas on transaction costs. North tried "to explain the historical transformation of property rights, legal systems, and other institutional arrangements by devising an explicit economic model of institutional change."[34] In 1970, North and Lance Davis sought to build a "model" which would predict economic-historical changes, given a set of institutions ("environment"), an institutional "arrangement between economic units," and disequilibrating forces. The explanation hinged on "an action group" which would seek institutional reforms if the members "recognized some potential income that *they* could receive if only they could alter the institutional structure." "Secondary action groups" spearhead such campaigns to capture extra income via one or another "institutional instrument."[35]

Next, total social income, externalities, "market failures," and other matters are canvassed, though we seem no wiser, in the end, than a traditional historian using his accustomed methods. Indeed, we may be less wise. For example, North and Davis write that the land values accruing to western farmers living near land bought up by a railroad typically rose dramatically, but the railroad could not somehow *charge* the farmers money for this unbidden positive externality. This is taken to be a terrible systemic "problem" that discourages the railroad from building, and thereby reduces the total social productivity and income. Given high information costs, North and Davis argue, risk and uncertainty may be so daunting that "markets [will] not operate at all."[36]

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[33]Gary North, *The Coase Theorem* (Tyler, Tex.: Institute for Christian Economics, 1992), p. xv.

[34]Sutch, "Douglass North and the New Economic History," pp. 14–15.

[35]Douglass C. North and Lance Davis, "Institutional Change and American Economic Growth: A First Step Toward a Theory of Institutional Innovation," *Journal of Economic History* 30, no.1 (March 1970), pp. 131–34.

[36]North and Lance, "Institutional Change and American Economic Growth," pp. 135, 137.

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This, apparently, is a case of market failure, but in practice it just tells us that certain people did not trade with one another and so that there was no "market" which could fail. We begin to see here an ominous reification of the market which has little to do with economics or history. For Davis and North, the crux of the matter seems to be the following:

> Although the profit does not come from an increase in total income, there are profits inherent in any arrangemental innovation that leads to a redistribution of income. Since successful capture means a loss to someone, the probabilities that such capture can be effected without reliance on some governmental coercive power are very small. In these cases, it is very likely that the gains can be captured only by the innovation of an arrangement that puts coercive power in the hands of a governmental secondary action group or that effects "enabling" legislation which permits some voluntary or quasi-voluntary group to artificially alter the supply of inputs or output of a good or service.[37]

Here the New Economic History begins more and more to resemble an elaborate "social-scientific" rationalization of the actual interest-group liberalism or corporatism of mid-twentieth-century America. We are not long held in suspense over this. We are told that "[t]he decision to let government underwrite canal investment during the 1830s was, given the primitive state of the American capital market, a rational one." Further, say Davis and North, as the American market grew in the nineteenth century, "it created potential profits for those who would innovate institutional arrangements to reduce transaction costs."[38]

The political method of "perfecting markets" and reducing various kinds of costs alleged to have been "too high" has, over the past three centuries, brought into being a number of political movements—Jeffersonian, Jacksonian, etc.—whose members knew they were paying for someone else's improved position, and accordingly rejected the innovations. Their grievances do not matter to the Coaseans and Northians, who hold that property rights are not absolutes, and the losers can't complain provided they are "compensated" by taxes levied on the winners.

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[37]North and Lance, "Institutional Change and American Economic Growth," pp. 137–38.

[38]North and Lance, "Institutional Change and American Economic Growth," pp. 146–47.

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Part of North's reworked system in his "middle period" of the New Economic History involved increased use of the Coasean theme of transaction costs. Over time, this supplanted or subsumed his older stress on location and transportation costs. In North's later work, indeed, attempts at reducing transaction costs became the key to political struggle as well as being the motor of western history.

Another important influence on North's new line of analysis was a paper written by Frederic C. Lane in 1958. In it, Lane discussed states as producers of a service: "protection." As specialists in violence, states were "natural monopolies" whose activities were a mixture of necessary policing and racketeering. Encumbered with the usual neoclassical assumptions and political biases, Lane saw no point in distinguishing payment for this service from plunder; a separation was not possible. As such, it would be useful to think of states as neoclassical *firms*.[39]

North soon mated these ideas with the Coasean focus on transaction costs, concluding that part of the "protection" provided by states was precisely the specification and allocation of property rights as such. When hypotheses are formed, given a set of mechanistic, neoclassical assumptions in which certain variables are functions of others, there tends to arise a search for the One Great Causal Key. Douglass North believed he found it in transaction costs. The outcome was the New Institutional History.[40]

The New Institutional History

In 1971, North expressed his desire to loosen his neoclassical bonds. Existing theory had "two major shortcomings. . . . It was not designed to explain long-run economic change" and, by assuming zero transaction costs, it could provide only "limited answers" to historical questions. What was needed was a theory that accounted for changes in the system of property underlying the whole economy. North believed transaction costs to be "the link between neo-classical theory and a broader study of property rights."[41]

In this newer body of work, we see North's discontent with standard theory driving him in the direction of the older institutionalism,

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[39]Frederic C. Lane, "Economic Consequences of Organized Violence," *Journal of Economic History* 18, no. 4 (December 1958), pp. 401–17.

[40]Swedberg, "Major Traditions of Economic Sociology," pp. 256–57.

[41]Douglass C. North, "Beyond the New Economic History," *Journal of Economic History* 34, no. 1 (March 1974), pp. 2, 4.

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and even toward a near-Marxist attempt to explain the logic of social-institutional change. In North's new system, a struggle to reduce transaction costs stood in for the Marxist class struggle as the driving force of western history and the explanation of western economic development, as against stagnation elsewhere.[42]

North and co-author Robert Paul Thomas presented the gist of this new interpretation of history in a 1971 article, and repeated it in their 1973 book, *The Rise of the Western World.*[43] This argument, centered on the transition from feudalism to capitalism, touched off much debate and formed the basis of North's later work. At issue was nothing less than a complete reorientation of western history.

For North and Thomas, late medieval "serfdom in Western Europe was essentially not an exploitative arrangement where lords 'owned' labor."[44] Instead, lords provided the "public good" of protection services in exchange for revenue. In the absence of developed markets, bargaining between lords and peasants was over goods in kind, leading to a choice between fixed wages, fixed rents, or forms of shared input. In this view, the costs of making such contracts and enforcing them determined the outcome, which was some form of shared production inputs.

Rising population led to a "frontier movement" into previously unused or sub-marginal land. This, in turn, stimulated the growth of wider markets. Thereafter, a dramatically lowered population—the result of the recurring plagues of the fourteenth century—strengthened the bargaining position of peasants, especially as lords came under inflationary pressures. Arrangements involving shared inputs gave way to "fixed money payment—the value to the tenant of the public goods he received" from the lord.[45] Finally, competition between lords for relatively scarce labor led to long-term leases approaching private property for the peasants.

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[42]In fact, some of North's adherents have made precisely this comparison with Marxism. See Heijdra, et al., "Marxism, Methodological Individualism, and the New Institutional Economics," pp. 296–317.

[43]Douglass C. North and Robert Paul Thomas, "The Rise and Fall of the Manorial System: A Theoretical Model," *Journal of Economic History* 31, no. 4 (December 1971), pp. 777–803; and Douglass C. North and Robert Paul Thomas, *The Rise of the Western World* (Cambridge: Cambridge University Press, 1973).

[44]North and Thomas, "The Rise and Fall of the Manorial System," p. 778.

[45]North and Thomas, "The Rise and Fall of the Manorial System," p. 794.

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Hereafter, North's work focused on the interaction between population, technology, and institutions specifying property rights, all referring back, in the end, to solving problems of transaction costs. The latter became the key variable in western history and the potential "explanation" of political outcomes, country by country, either of sustained economic growth, or of failure to achieve sustained growth, when the institutional structure was not modified so as to resolve transaction cost problems. Needless to say, whatever North's intentions at the start of his project, a kind of transaction-cost determinism soon characterized his work.

By 1979, North was calling for a more explicit "model" of the state as the next stage in understanding institutional development.[46] In his 1981 book, *Structure and Change in Economic History,* North undertook to answer those who had questioned his discussion of the transition from feudalism.[47] In 1988, developing Simon Kuznet's notion that defense expenditures were an "intermediate" product and not an "end product," North and John Joseph Wallis asked if transaction costs should "be subtracted" from figures for GNP.[48] They claimed that transaction costs accounted for some 30% of the U.S. economy, a proportion which has only grown in North's later work.[49]

In a major article in 1989, North and Barry R. Weingast explained the politics of seventeenth-century England in terms of the struggle to specify and secure property rights, all in the shadow of transaction costs.[50] The authors do manage to show that the triumph of the Whigs secured *some* people's property rights. However, their claim that the

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[46]Douglass C. North, "A Framework for Analyzing the State in Economic History," *Explorations in Economic History* 16 (1979), pp. 249–59.

[47]Douglass C. North, *Structure and Change in Economic History* (New York: W.W. Norton, 1981).

[48]Douglass C. North and John Joseph Wallis, "Should Transaction Costs be Subtracted from Gross National Product?" *Journal of Economic History* 48, no. 3 (September 1988), pp. 651–54.

[49]See Douglass C. North's 1994 lecture, "Institutions, Organizations and Market Competition," *http://www.ie.boom.ru/Library/North4.html.* In this version, transaction costs considered as "social costs" have eaten half the economy and threaten us with the end of life as we know it.

[50]Douglass C. North and Barry R. Weingast, "Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth-Century England," *Journal of Economic History* 49, no. 4 (December 1989), pp. 803–32.

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Bank of England raised economic gains to otherwise impossible heights does not seem as conclusive as they believe it to be.

In further scholarly productions, North sought to tighten his theoretical model, or models, with better definitions of institutions.[51] In his further moves away from neoclassical assumptions, North has concluded that a major task of future economic-institutional history is to show how ideology is based on information costs.[52] After all, it would be wrong to leave ideology to mere historians.

By 1994, North was writing about the importance of a "theory of economic dynamics" for the study of economic development over time. He had shed or loosened more and more of the assumptions which had given "mathematical precision and elegance" to the "frictionless and static world" in the original neoclassical synthesis, retaining only "the fundamental assumption of scarcity and hence competition and the analytical tools of microeconomic theory." His new formulation, he wrote, "modifies the rationality assumption" and "adds the dimension of time."[53] This last turn is very interesting from an Austrian standpoint, but it seems to have come too late in the game to pull North's theoretical wagon out of the historical ditch.

Thus, over forty years, North continued to work out of a theoretical outlook in which economies somehow generate a lot of stuff. Economic competition and political strife spring up over the "capturing of gains from trade" or the sharing of potential "rents."

A Critique of the Fundamentals of the Northian Paradigm

North has advanced some bold theses and, in his favor, it must be said that he does not always write in the manner of those who see history as a huge reservoir of empirical data which exists mostly so that hypotheses may be tested, falsified, and then re-tested. He believes that we can learn from history, that economic history is interesting and

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[51]Cf. Douglass C. North, *Institutions, Institutional Change, and Economic Performance* (Cambridge: Cambridge University Press, 1990); and Douglass C. North, "Institutions," *Journal of Economic Perspectives* 5, no. 1 (Winter 1991), pp. 97–112.

[52]Heijdra, et al., "Marxism, Methodological Individualism, and the New Institutional Economics," pp. 301–2.

[53]Douglass C. North, "Economic Performance Through Time," *American Economic Review* 84, no. 3 (June 1994), p. 359.

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important in itself, that there are lessons for policy, and that our understanding is increased by the enterprise of history. His willingness to take theory into history and to rethink his position when it seems to be wrong is admirable. It is too bad, however, that the theory he took into his enterprise was badly flawed, and that he created his syntheses without perhaps correctly understanding the difference between history and theory.

One might well wish, along with North, for a theoretical explanation of historical change, especially one that was systematic and directional. This accounts for the appeal of a theory which grafts the acting, maximizing individual onto big trajectories of collective action and property-"rights" specification. Unhappily, the theory provided by North seems somewhat wanting. While there are many nods in the direction of recognizing incentives that exist for state rulers, in the end, the Northian paradigm seems less realistic on these matters than does Marxism itself. In fact, the work of North and his allies on early modern history looks like nothing so much as an attempted explanation, on the basis of neoclassical economics, of the old Marxist problem of *how the bourgeoisie seized the state*.

Standing outside those two problematics, it seems more worthwhile to ask if, when elements of the bourgeoisie allied themselves, somewhere, sometime, with kings and against local aristocrats: 1) they can be seen as having stood in for all the bourgeoisie; 2) they were knowingly trying to reduce transaction costs; 3) they made a big historical mistake by not seeing what they were getting into; and so on. Concrete analysis would reveal purposive individuals making up differing blocs with different interests, acting out of differing motives, including plunder-seeking, avoiding trouble, and ideological commitments.

The more we know about such things, the more ready we will be to address the much more interesting question of *how the state seized the bourgeoisie*. Of course, to ask such a question is already to see more day-to-day "autonomy" and self-interest in the state than is customary, even among such Chicago School heirs as the Northians and the public-choicers.[54]

North's reading of the rise of the West empties the whole seventeenth-century crisis of any real meaning. At the very least, the seventeenth century witnessed massive popular resistance to ever-higher levels of state predation, resistance which fielded new and old ideas about the

[54]Murray N. Rothbard, "Public Choice: A Misshapen Tool," *Liberty* 2, no. 5 (May 1989), pp. 20–21.

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proper limits of government power, that is, liberalism and constitutionalism.[55] Casting this struggle as "bargaining" over transaction costs seems quite perverse.

Even worse, Lane's and North's neoclassical equation of states with "firms" is *a literal inversion of Gustave de Molinari's insights about markets for protection.*[56] The Belgian economist argued in 1849 that if, as economists believed, free competition led to the best possible results in all other markets, the same would be true in the field of protection or security. At the same time, monopolistic states had all the disadvantages of other monopolies. It followed that social progress required the supply of protection through voluntary agencies and the abolition of states. North's position is also a literal reversal of the early liberals' account of how freedom and security of property promoted prosperity.

North's lack of realism about states is staggering.[57] Ideas, even interests, are left somewhat in the historical ditch by this approach. In the end, "models" rule the Northian world, and purposive individuals vanish. If necessary, "ideology" will be introduced, but only as another "variable"; no believable, acting human beings need apply. Such an approach necessarily involves neglect or loss of real insights available to historians using what Ludwig von Mises called "thymology"—a sort of everyday social psychology[58]—alongside economic theory to achieve understanding (*Verstehen*) of the complex details and unique events of history. The historian must often discover the "events" themselves and

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[55]Niels Steensgaard, "The Seventeenth-Century Crisis," in *The General Crisis of the Seventeenth Century*, ed. Geoffrey Parker and Lesley M. Smith (London: Routledge and Kegan Paul, 1978), pp. 25–56.

[56]Gustave de Molinari, *The Production of Security* (New York: Center for Libertarian Studies, 1977). See also Hans-Hermann Hoppe, "The Private Production of Defense," *Essays in Political Economy Series* (Auburn, Ala.: Ludwig von Mises Institute, 1998). Lance Davis, in "It's a Long, Long Road to Tipperary, or Reflections on Organized Violence, Protection Rates, and Related Topics: The New Political History," *Journal of Economic History* 40, no. 1 (March 1980), p. 9, remarks, rather mildly: "Political markets tend not to work as freely as economic ones."

[57]For a realistic view, see Murray N. Rothbard, "Anatomy of the State," in *Egalitarianism As a Revolt Against Nature* (Auburn, Ala.: Ludwig von Mises Institute, 2000), pp. 55–88.

[58]See Ludwig von Mises, *Theory and History* (Auburn, Ala.: Ludwig von Mises Institute, 1985); and Joseph T. Salerno, "Introduction" to Murray N. Rothbard, *A History of Money and Banking in the United States* (Auburn, Ala.: Ludwig von Mises Institute, 2002), pp. 17–23.

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define their boundaries[59] and weigh all manner of possible causal relations with the help of all relevant bodies of outside knowledge. Economic theory has here as much (or as little) role as do chemistry, ballistics, and physics. Historians do not, however, give up studying the past merely because history itself is not a natural science.

Specific Objections to North's Reconstruction of Western History

Historians following their customary methods have gotten somewhat different results than has North. Recent work on feudalism has so altered our perception of "feudal" society that the whole problem of the "transition" from feudalism to capitalism is receding to manageable proportions. The key seems to be the "divided sovereignties" that characterized European society.[60] While North might go part of the way with this notion, his reconstruction seems in some ways seriously to downplay the autonomy of the political.

If anything, it may be the case that two antagonistic tendencies were in conflict from the late Middle Ages onward. On the one hand, cities sprang up and economic activity increased (for whatever reason), while, on the other hand, Kings began building modern states which incorporated others' territories and fought wars with like entities for expansion and survival. The competition between these rising states put pressure on growing economies and extracted resources from them on an unprecedented scale.

These pressures from war-making centers of organized crime, so to speak, built some states and eliminated others.[61] It is hard to find much

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[59]Gordon Leff, *History and Social Theory* (Garden City, N.Y.: Anchor Books, 1971); and Peter Munz, *The Shapes of Time* (Middletown, Conn.: Wesleyan University Press, 1977).

[60]Ralph Raico, "Prolegomena To a History of Liberalism," *Journal des Economistes et des Etudes Humaines* 3, nos. 2/3 (June-September 1992), pp. 259–72.

[61]See, for example, Charles Tilly, "War Making and State Making As Organized Crime," in *Bringing the State Back In*, ed. Peter B. Evans, Dietrich Rueschemeyer, and Theda Skocpol (Cambridge: Cambridge University Press, 1985), pp. 169–91; Charles Tilly, "Futures of European States," *Social Research* 59, no. 4 (Winter 1992), pp. 705–17; Margaret Levi, "The Predatory Theory of Rule," *Politics and Society* 10, no. 4 (1981), pp. 431–65; and John A. Lynn, "How War Fed War: The Tax of Violence and Contributions during the *Grand Siècle*," *Journal of Modern History* 65 (June 1993), pp. 286–310.

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economic rationality or conscious reduction of transaction costs in the process. Certainly, despite his calls for a "model" of the state, North rather underestimates the self-regarding motives and actions of rulers. The most he can show is that some rulers became smart enough to not provoke violent uprisings over taxes every week.

As for North and Thomas's account of the waning of the medieval manor, Stefano Fenoalta has written that their:

> view of feudalism as a strictly voluntaristic system whereby the peasants obtained a public good seems empirically untenable, given the nature of the services actually provided by the lord, and the narrowness of the alternatives among which the peasants could choose.[62]

Theda Skocpol, criticizing historian Barrington Moore, Jr.'s similar claim about services-exchanged-for-revenue, wrote that:

> any upper class quite *un*manipulatively creates through its own existence and activities many of the problems that it simultaneously overcomes in "service" to "the community." Thus, if feudal lords had not been so wont to fight among themselves, "their" peasants would not have needed the protection for which they supposedly "gave" their surpluses in "fair exchange"![63]

Skocpol's criticism of Moore's Marxist argument applies equally well to North's claim, and the point would seem to apply even more to territorial states, a problem which seems largely absent from North's scheme of things. Economic historian E.L. Jones wrote of North and Thomas's work that:

> Their system is a "baggy" one which assumes a new shape depending on where one picks it up. The very generality which is the strength of economic reasoning may become something of a liability when faced with the perplexity of history.[64]

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[62]Stefano Fenoalta, "The Rise and Fall of a Theoretical Model," *Journal of Economic History* 35, no. 2 (June 1975), p. 408. North did change his argument to meet Fenoalta's criticisms; see North, *Structure and Change in Economic History*, pp. 129–31.

[63]Theda Skocpol, "A Critical Review of Barrington Moore's *Social Origins of Dictatorship and Democracy*," *Politics and Society* 4, no.1 (Fall 1973), p. 9, emphasis in the original.

[64]E.L. Jones, "Institutional Determinism and the Rise of the Western World," *Economic Inquiry* 12, no. 1 (March 1974), p. 121.

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And John L. Campbell and Leon N. Lindberg note that the "capacity to establish property rights gives the state a generally unrecognized source of *strength* insofar as it enables state actors to alter the organization of the economy."[65] This points toward states with considerable anti-social autonomy, rather than toward some sort of more-or-less-benign bargaining process between states and interest groups or citizens, leading to reductions of transaction costs.

North and Weingast's portrait of the English Whig oligarchy as a set of cost-reducers and property-specifiers in the face of the predatory Stuart kings has also come under fire. According to Bruce G. Carruthers:

> It was [James II's] Catholicism more than his absolutism that turned his subjects against him. The wealth holders of England who engineered the Glorious Revolution were more concerned with popery than with property.[66]

But this is a minor problem compared with North and Weingast's assumption that the Bank of England and monetized public debt were necessary instruments of economic progress.[67]

On any sustained reading, the whole Northian program seems a huge after-the-fact rationalization for what *did* happen, with the result that it is about as "predictive" in this way as is Marxism; and why, after all, does a historian need to *predict* the past? The "variables" specified are said to have been the very ones at work, because they are the ones the *model* requires. Political theorist Hendrik Spruyt makes just this point about the New Institutional History (NIH), when he writes:

> The existence of the institution is imputed to derive from the functions it performs. NIH assumes a direct connection between the preferences for an institution that would perform certain functions and the actual existence of a given institution. Sometimes preferences are then deduced tautologically from the functions that the existing institution performs. Finally, transaction costs are often imputed post hoc,

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[65]John L. Campbell and Leon N. Lindberg, "Property Rights and the Organization of Economic Activity by the State," *American Sociological Review* 55, no. 5 (October 1990), p. 635, emphasis in the original.

[66]Bruce G. Carruthers, "Politics, Popery, and Property: A Comment on North and "Weingast," *Journal of Economic History* 50, no. 3 (September 1990), p. 697.

[67]For a more realistic account, see John Brewer, *The Sinews of Power: War, Money, and the English State, 1688–1783* (New York: Alfred A. Knopf, 1989); and for a critique, see Murray N. Rothbard, *Economic Thought Before Adam Smith*, vol. 1 of *An Austrian Perspective on the History of Economic Thought* (Cheltenham, U.K.: Edward Elgar, 1995), pp. 229–30.

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as well. Depending on whether a particular outcome occurred, transaction costs are suggested to have been high or low.[68]

Theory and History

There are other such points which might be mentioned here. But the whole Northian project is wildly counterintuitive, and one must ask again: Does it make any sense to "do" economic history in this fashion? Evidently it does not, especially as there are no "directional laws" of history.[69]

In contrast to the neoclassical would-be historians and their use of unreal concepts susceptible to mathematical expression and/or abstract modeling, actual historians *can* use economic theory, or the pure theory of human action underlying it, to aid their reconstruction of the past. They can do this without overlooking the difference between the unrepeatable data of history and the principles derived from theory. Specific insights about human action in general can be used to rule out causal explanations which, in principle, could not be true, to define limiting cases, and so on. Thus, for example, sound theory tells the historian that if a general economic depression occurred, he should look for a prior episode of monetary inflation; it does not tell him that every inflation will lead to a depression.

This is precisely how Murray Rothbard, as a historian, deployed theory in *A History of Money and Banking in the United States*. On a more general level, Hans Hoppe's use of theory as a guide in reconstructing history also stays within proper methodological boundaries of theory and history.[70] Joseph T. Salerno's introduction to Rothbard's *History of Money and Banking in the United States* ably expounds the Misesian-Rothbardian view of historical method within the Austrian tradition.

North's system, however, conflates unlike methodologies and two very different disciplines in a vain attempt to convert statics into dynamics by way of "evolutionary-institutional" explanations. One stumbles at the threshold. Richard R. Nelson, a scholar interested in developing an evolutionary-theoretical economics, observes that "while evolutionary

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[68]Hendrik Spruyt, "Institutional Selection in International Relations: State Anarchy as Order," *International Organization* 48, no. 4 (Autumn 1994), pp. 532–33.

[69]Mises, *Theory and History*, pp. 210–14.

[70]Hans-Hermann Hoppe, *Democracy—The God That Failed* (New Brunswick, N.J.: Transaction Publishers, 2001).

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theory may provide a useful language for historical discussion, the theory has little predictive power, and its explanations are at least partially ad hoc."[71] Nelson notes North's long march through the theories, writing that North once upheld, but has retreated from, evolutionary language.

Joseph Salerno's comments on North are more biting:

> This endeavor of North and others to deliberately extend the positivist program to economic history immediately confronts two problems. First, as North emphasizes, this approach narrowly limits the kinds of questions that can be investigated. . . . Those issues which do not readily lend themselves to formulation in quantitative terms or for which statistical data are not available tend to be downplayed or neglected altogether. . . . [The positivist] method precludes them from . . . identifying the ex ante purposes as well as ideas about the most efficacious means of accomplishing these purposes that motivated the specific individuals who lobbied for or initiated the change that effected a new income distribution.[72]

The second problem in North's approach is the relationship it posits between theory and history. Salerno recommends the program discussed by Mises and implemented by Rothbard which unites the pure logic of action (praxeology) with the method of understanding actors' motives by means of generalizations from social experience (thymology). A unique contribution by Rothbard was his insight that historical actors' often try to shift others' income to themselves by political means, and that they need, therefore, to spin justifying ideologies to obscure what is actually at stake.[73]

North, by contrast, often criticizes governments for having gotten in the way of economic growth historically, but despite his "modeling" of the state, has fewer useful things to say about rulers and their incentives than do Austrians or Marxists.

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[71]Richard R. Nelson, "Recent Evolutionary Theorizing About Economic Change," *Journal of Economic Literature* 33, no. 1 (March 1995), p. 67.

[72]Salerno, "Introduction," p. 9.

[73]The notion of the "political means to wealth" runs through all of Rothbard's work on economic history, mercantilism, and politics. See, e.g., Murray N. Rothbard, "Anatomy of the State," in *Egalitarianism As a Revolt Against Nature* (Auburn, Ala.: Ludwig von Mises Institute, 2000). A good summary of Rothbard's position is found in Salerno, "Introduction," esp. pp. 10–37. Mises developed his notion of "thymology" partly in reaction to Max Weber's discussions of the use of "ideal types" in history and sociology.

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The View From the Top: Social Costs and System Adjustment

It will be useful now to look into some of the assumptions on which the NIH and related schools rest. At bottom, the infelicities of the Northian world outlook stem from the inversion (already noted) of early liberalism's insights into European development in relation to freedom and secure property rights. There is with such thinkers as Lane and North a full-blown mishandling of the relationship between carts and horses.

Rather than consider that "problems" of cost—transaction, information, whatever—arise on the basis of any human action whatsoever and, therefore, to that extent *presuppose* some sort of property and the possibility of exchange, the New Economic / New Institutional Historians make compulsory third-party enforcement of contracts and rules a precondition of economic action. As with Marxism, property and purposeful action become *effects* of an institutional arrangement. Putting himself in the imagined place of a central planner, the neoclassical-economist-turned-historical-Grand-Theorist claims to sift and arrange an unwieldy ensemble of economic-historical data and to factor in all manner of unknowable and unmeasurable subjective past costs in order to yield "testable and falsifiable theories" about how institutions emerged or failed to do so, and how economies either grew or did not grow. This falls only slightly short of an attempt to solve the socialist calculation problem in reverse.[74]

From the standpoint of the abstracted economic system as a whole, when supposed "divergences" between individual and "social" costs arise, they must be addressed at the level of the whole and, therefore, by the states in the form of rational bureaucracy, legislature, or Coasean judge. When, in their wisdom, these authorities reassign property "rights," the losers must be "compensated" by a tax on the winners. This follows from the counterintuitive Coasean claim that both sides in a dispute over "externalities" are right, while at the same time, both are wrong. Judge Posner must do the math, and, Presto! we are blessed with the no-fault, "free-market" socialism of endlessly adjustable property "rights" at the level of the social whole.

A central imperative of the Chicago tradition in the widest sense appears to be an impatient growthmanship, demanding maximization

[74]It is interesting in this connection that the social calculation debate of the 1920s and 30s was carried on, by the socialists, largely in the language of neoclassical theory. See Oskar Lange and Fred M. Taylor, *On the Economic Theory of Socialism*, ed. Benjamin E. Lippincott (New York: McGraw Hill, 1964).

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of *social* productivity by way of a sustained crusade to reduce "transaction costs." Growth is thereby enthroned as an unexplained, free-standing normative goal. One is reminded of Benny Hill's joke about the neutron bomb which kills the people, but leaves the real estate intact. "We have that already in England," he quipped, "it's called the mortgage." In a similar way, the Chicagoites allegedly preserve the people while destroying the property rights which support them. Imaginary models give rise to reified "markets" that become more real than are acting humans in actual markets.[75]

As wielded by North and his allies, the transaction cost concept has been "stretched to the breaking point," as economic historian Robert Higgs commented.[76] As Murray Rothbard said of the views of Ronald Coase and Harold Demsetz, "It is simply assumed without adequate support, for example, that external economies *should* be internalized. But why? What is the ethical groundwork for this position?"[77]

Further, the whole notion of "social" costs is per se questionable, without even trying to reconstruct them for the past. Rothbard writes:

> Professor Demsetz goes on to advocate an allocation of property rights in accordance with whichever allocation involves lower total social transaction costs, such as costs of enforcing the given property right. But once again, there are two grave flaws in this position. One, since social costs embody psychic costs or disutilities for each individual, it is impossible to measure and hence to add them up interpersonally. But apart from this, such a gauge for the allocation of property rights brusquely sets aside any consideration of the justice of property titles.[78]

In any case, the claim that "social costs *should* be minimized, or that external costs *should* be internalized, is not a technical or a value-free position." Elsewhere, Rothbard writes:

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[75]The neoclassical drive to fetishize imaginary prices in abstract markets affects socialists as well. Thus, West German feminists demanded some years ago that the state pay women "wages" for housework *as if* there existed a market which could generate prices for such work. Paleo-Marxist André Gorz made short work of this argument in *Farewell to the Working Class* (Boston: South End, 1982), pp. 82–85.

[76]Robert Higgs, "Eighteen Problematical Propositions in the Analysis of the Growth of Government," *Review of Austrian Economics* 9, no. 1 (1991), p. 29.

[77]Murray N. Rothbard, "Value Implications of Economic Theory," chap. 11 in *Money, Method, and the Austrian School*, p. 261, emphasis in original.

[78]Rothbard, "Value Implications," p. 262.

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> There is the grave fallacy in the very concept of "social cost," or of cost as applied to more than one person. For one thing, if ends clash, and one man's product is another man's detriment, costs cannot be added up across these individuals. But second, and more deeply, costs, as Austrians have pointed out for a century, are subjective to the individual, and therefore can neither be measured quantitatively nor, *a fortiori*, can they be added or compared among individuals.

It follows that "of course any concept of social costs, including transaction costs, becomes meaningless." Finally, costs are ephemeral, existing only ex ante. Having acted, a particular "cost disappears" and "becomes a historical cost, forever bygone," and not subject to reconstruction by a later observer.[79]

The whole transaction cost conundrum which North puts at the center of history reveals an interesting kinship with the neoclassical construction of "monopoly" and, thus, with the socialist calculation problem, or even the "feudal calculation problem" as presented by North (albeit from the wrong end of the telescope). Gerald P. O'Driscoll, Jr. and Mario J. Rizzo noticed this when they wrote that:

> Coase's approach to the existence of firms [is] congenial [to an Austrian analysis and] incorporates the essential conclusion of the economic calculation debate. That is, calculation of profits and losses is impossible without competitive markets for inputs. Gains from hierarchical organizations can be captured only so long as they do not completely eliminate factor markets. Coase's approach is an excellent *static* conceptualization of the problem.[80]

On Reducing the Costs Arising from Fretting about Transaction Costs

It seems highly unlikely that history has been a struggle over transactions costs. R.C.O. Matthews comments that, for the most part:

> Transaction costs are costs of relations between people and people. . . . The objective of the economic agent is not to

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[79]Murray N. Rothbard, "The Myth of Efficiency," chap. 12 in *Money, Method, and the Austrian School*, pp. 269–70.

[80]Gerald P. O'Driscoll, Jr., and Mario J. Rizzo, *The Economics of Time and Ignorance* (Oxford: Basil Blackwell, 1985), pp. 123–24, emphasis added. Also see Murray N. Rothbard, *Man, Economy, and State* (Auburn, Ala.: Ludwig von Mises Institute, 1993), pp. 560–660.

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> minimise transaction costs as such, but to minimise the sum of transaction costs and production costs. There may be tradeoffs between the two.[81]

If we referred to these things as "costs of doing business," they would likely sink to their proper level of importance in the scheme of things. Costs are costs, as Rothbard's discussion suggests,[82] and transaction costs have no special characteristics all their own. All actions involve costs; to do one thing is to forgo doing some real alternative. Prefixing "trans-" to "action" does not and cannot create a special kind of cost with exceptional properties.[83]

Rothbard points out that governments are not "costless" agencies able magically to reduce everyone's transaction costs as needed. For example, it costs the state something to track down "free riders" (those amoral souls who fail to pay their "fair share" toward some public good). Such "cheating" follows logically from the model of "maximizing rational individual," but in real life, people behave better than in models, otherwise civilization itself would not exist.[84] Of course, it does not follow that the state should be providing this public good in the first place, nor that the so-called free rider would want the good if its purchase were left to his voluntary action.

This whole set of related problems results from attempts to justify the activity of states, or to account for certain results of that activity. In the perspective typically adopted, planners are seen as capable of making Benthamite interpersonal comparisons of utility and social utility, or, failing that, to discover and adjust social costs. But societies and markets, that is, people, are constantly overcoming and lowering costs of all kinds. The "invention" of money and, before that, the "invention" of language, if we may call it that, must have lowered costs tremendously, and with no state on hand to shove things along. If reduction of costs were a proper role of the state—and, indeed, something states could do or would wish to do—then by the same logic that demands state imposition of

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[81]Matthews, "Economics of Institutions and the Sources of Growth," p. 906.

[82]Murray N. Rothbard, "The Myth of Neutral Taxation," in *Applications and Criticisms from the Austrian School*, vol. 2 of *The Logic of Action* (Cheltenham, U.K.: Edward Elgar,1997), pp. 87–88.

[83]The Roman Law typically divided its subject matter into persons, things, and actions.

[84]Jeffrey Rogers Hummel, "National Goods Versus Public Goods: Defense, Disarmament, and Free Riders," *Review of Austrian Economics* 4 (1990), pp. 110–11.

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weights and measures, states would be justified in making everyone learn English.

Just looking at it, it seems passing strange that if states are hard at work ridding us of transaction costs, North should spot a threatening increase in such costs, an increase which exactly parallels the expansion of governmental activity. One suspects a scam, on par with government efforts to combat inflation. As Robert Higgs puts it:

> Modern governments—the American and just about all the others—hugely *increase* the costs of transacting mutually beneficial exchanges in comparison with what those costs would be in a minimal or night-watchman state.[85]

Considering all the money paid so that lawyers may resolve transaction cost problems—having first created those problems in their capacity as legislators, bureaucrats, and advisors to states—one sees how the growth of arbitrary "laws"and state colonization of the life-world (to use a Habermasian expression) has unflinchingly *increased* such costs. One can also see why Coasean theses would appeal to lawyers. Self-interested maximization? You bet. Caused by the inherent logic of property and markets? Probably not.

States might, however, sometimes wish to reduce their *own* administrative costs. This explains state imposition of standard weights and measures, metrication, stable surnames, and so on. And states often prefer and promote large firms because having to deal with fewer independent entities reduces the costs of tax collection, regulation, and so forth.[86] Altruistic adjustment of "social costs" has probably not driven many state actions in history. State action is far better studied in terms of strategic command posts over society, ideological mystification, and the kinds of incentives present to those who get their income by compulsion.[87]

Douglass North and the Close of His System

In the end, the differences between an Austrian "free-market" view of policy and history, and that of the broader Chicago School, including the Northians, arise from irreconcilable differences in ethics and

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[85]Higgs, "Eighteen Problematical Propositions," p. 30.

[86]See Jim Scott, "Socialism and Small Property—Or—Two Cheers for the Petty Bourgeoisie," *Peasant Studies* 12, no. 3 (Spring 1985), pp. 191–95.

[87]See Rothbard, *Man, Economy, and State*, chap. 12, pp. 765—890; and Hoppe, *Democracy, passim.*

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epistemology. Hans Hoppe observes, in his introduction to Murray N. Rothbard's *Ethics of Liberty,* that when "Ronald Coase, Harold Demsetz, and Armen Alchian . . . began to redirect professional attention to the subject of property and property rights," the path they took was "categorically different" from that of Rothbard. As members of the Chicago School, these men:

> unswervingly accepted the reigning positivistic dogma that no such thing as rational ethics is possible. . . . [Hence,] the term property had to be stripped of all normative connotations attached to it in everyday "non-scientific" discourse.[88]

Rothbard noted that because some system of property rights is necessary in any society to lessen potential conflicts, the Chicago School's solution is to have assignments of property rights "made by government judges—based on utilitarian considerations and calculations."[89] In the Rothbardian-Hoppean view, private property is and *should be* the starting point of the analysis. And recall that Gary North regards the Coase Theorem as one of the most dangerous attacks ever made on private property.

This is rather striking in view of the tendency of left liberals and socialists to see the Chicago School and its heirs and assigns as "right-wing" and "reactionary" defenders of property and capitalism. This may be true, but only if an *ad hoc*, pragmatic defense of the state-ridden status quo is taken as a near-substitute for a principled defense of private property. In truth, Chicago School economics in its various manifestations functioned as the right-wing of Cold War liberalism.

As Laurence H. Tribe points out, the "systematic development" of the bureaucratic "policy sciences" began with "British and American responses to the onset of World War II."[90] When war liberalism became Cold War liberalism, the social engineers were ready to serve under the same epistemology and with the same methods. One example of semi-official anti-Soviet scholarship was W.W. Rostow's growth-and-takeoff model, with which the cliometricians and New Economic Historians were at first in competition.[91]

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[88]Hans-Hermann Hoppe, "Introduction" to Murray N. Rothbard, *The Ethics of Liberty* (New York: New York University, 2002), pp. xii–xiii.

[89]Hoppe, "Introduction," p. xiii.

[90]Laurence H. Tribe, "Policy Science: Analysis or Ideology?" *Philosophy and Public Affairs* 2, no. 1 (Autumn 1972), p. 67.

[91]Rostow, *The Stages of Economic Growth.*

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North has strived to trace the beginnings of economic growth, but in a way that calls to mind the Marxists' quest for "primitive accumulation of capital." It is not enough for people to produce and exchange. Someone or something—the state, the "institutional mixture," whatever—must kick-start the motor of economic progress, showing, if nothing else, the sort of bind into which one can get by taking mechanical metaphors too literally. Mechanism and its corresponding political orientation are rooted in the Anglo-American, anti-realist, nominalist tradition of Bacon, Hobbes, and Bentham. As radical historian R. Jeffrey Lustig writes:

> Hobbes's nominalism has been frequently discussed, as has his authoritarian social theory. But the organic connection between the two has usually been ignored. If, however, as Hobbes said, there is "nothing absolutely so, nor any common rule to be taken from the nature of the objects," then any common rule that exists must be imposed *upon* those objects. The political implications follow straightforwardly. Where social order is not conceived as a product of participation or shared intentionality, external rules must emerge as the only source of social cohesion. Once the mind of the individual has been ignored for operational manipulation and force, as the result of managing objects externally, rather than of dealing with subjects rationally. The question of rights becomes irrelevant from such a perspective because nominalist particulars lack any deep structure of legitimacy. Paradoxically, the philosophic nominalism which at first appears to mandate great respect for particulars comes out, with regard to politics, supporting a doctrine that easily denies the integrity of those particulars.[92]

Northianism recapitulates the unedifying flirtations between history, on the one side, and Grand Theory and Abstracted Empiricism (the natural progeny of positivism and Anglo-American empiricism), on the other, which have flared up, from time to time, from the 1960s (and earlier) down to the present.[93] In the sixties, the paladins of Abstracted

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[92]R. Jeffrey Lustig, *Corporate Liberalism: The Origins of Modern American Political Theory, 1890–1920* (Berkeley, Calif.: University of California Press, 1982), p. 181; cf. Hans-Hermann Hoppe, "The Socialism of Social Engineering and the Foundations of Economic Analysis," in *A Theory of Socialism and Capitalism: Economics, Politics, and Ethics* (Boston: Kluwer, 1989), pp. 95–125.

[93]See Mills, *Sociological Imagination*, chaps. 2 and 3; and cf. Rothbard's strictures on social-scientific talk about "mathematical functions" in *Man, Economy, and State*, pp. 277–79. On sociology as a methodology posing as a discipline, see Stephen Turner, "The Origins of 'Mainstream Sociology' and

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Empiricism in economic history were the Cliometricians, while North chose the path of Grand Theory. The outcome was the abortive cramming of historical material into unrealistic *a priori* trajectories of development.

Perhaps Fritz Redlich was premature in exempting Douglass North from the full force of his (Redlich's) critique of the use of figments in economic history. North's brilliant efforts in support of what seems a fundamentally flawed system call to mind what Joseph Schumpeter said of the Austro-Marxist Otto Bauer's analysis of ethnic conflict in the Austro-Hungarian Empire: "the skill of the analyst only serves to show up the inadequacy of the tool."[94]

In a real sense, both North's "middle way" corporatism and the socialism of the Marxists amount to an attempt to solve minor, trivial, and manageable "free rider" and transaction cost problems by creating, in their place, immense and insoluble problems. This means, in effect, that the whole "free rider" dilemma, like the whole discussion of "distribution,"[95] is an effect of the existence of states and not something built into the nature of things such that states can take it in hand and "solve" it. All states can do is make it worse.

It is interesting that North has turned at last to the problem of ideology. His own system has taken on the character of an ideology suited to the present situation of the western welfare-warfare states. It is the sort of thing around which a Republican administration in the United States or a Social Democratic government in Germany could unite in everlasting Vital Center tandem. This is unfortunate because North is a very productive and often insightful scholar undone, one might say, by his commitments to assumptions overdue for interment.

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[94]Joseph Schumpeter, *Capitalism, Socialism, and Democracy* (New York: Harper Torchbooks, 1962), p. 15.

[95]See Rothbard, *Man, Economy, and State*, pp. 554–56, on this fallacy.

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